

Consultation Paper

Draft implementing technical standards

On currencies for which the justified demand for liquid assets exceeds the availability of those assets under Article 419(4) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)



Consultation Paper on draft implementing technical standards on currencies for which the justified demand for liquid assets exceeds the availability of those assets under Article 419(4) of Regulation (EU) 575/2013 (Capital Requirements Regulation – CRR)

Contents

1.	Responding to this consultation	3
2.	Executive summary	4
3.	Background and rationale	6
4.	Draft implementing technical standards on currencies for which the justified demand for liquid assets exceeds the availability of those assets under Article 419(4) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)	14
5.	Accompanying documents	19
5.1	Draft cost-benefit analysis / impact assessment	19
5.2	Overview of questions for consultation	21

1. Responding to this consultation

The European Banking Authority (EBA) invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in section 5.2.

Comments are most helpful if they:

- respond to the question posed;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed / rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 22 December 2013. Please note that comments submitted after this deadline, or submitted by other means, may not be processed.

Publication of responses

Please indicate clearly in the consultation form whether you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) No 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found in the [Legal notice](#) section of the EBA website.

2. Executive summary

The Capital Requirements Regulation (CRR) sets out prudential requirements for liquidity which will be applicable as of 1 January 2014.

In a number of articles the CRR contains specific mandates for the EBA to develop draft regulatory or implementing technical standards (RTS and ITS) relating to liquidity requirements. These standards will be part of the single rulebook enhancing regulatory harmonisation.

Main features of the RTS

This consultation paper proposes draft ITS relating to Article 419(4) CRR, which requires the EBA to list the currencies with constraints on the availability of liquid assets. For these currencies, the justified needs for liquid assets in light of the liquidity coverage requirement in Article 412 exceed the availability of those liquid assets in a currency. In accordance with Article 419(2), two types of derogations shall apply for these currencies. The derogations are intended to address the inherent difficulties that institutions would face in meeting their liquidity coverage requirement in such currencies where it is not possible to reduce, by sound liquidity management, the resultant need for liquid assets and the holdings of those assets by other market participants. It should be noted that the EBA is also consulting, in parallel to this consultation, on an RTS under Article 419(5) CRR to specify the use of the abovementioned derogations.

In the draft ITS the list of currencies has been specified on the basis of data gathered by the Member States and a set of assumptions that result in shortage estimates per currency. The data collection process has been completed for two currencies, namely the Norwegian krone (NOK) and the Danish krone (DKK), the results of which have determined their addition to the list. All competent authorities in the European Economic Area (EEA) had the opportunity to complete an assessment of whether or not there were constraints on the availability of domestic currency liquid assets, to determine the inclusion of their domestic currency in the ITS. However, for currencies other than NOK and DKK, a data-gathering exercise was either not pursued or completed for various reasons, primarily relating to the insufficiency of available domestic currency liquid assets or, in limited circumstances, because robust data and documentation to support such an analysis could not be obtained.

Currencies outside the EEA have not been included in the current evaluation, due to, inter alia, the need to focus on the most relevant currencies and constraints to data availability. In particular, estimates of the demand for liquid assets that the implementation of the Basel III liquidity coverage requirement would create for non-EEA jurisdictions are not easily available. In addition, the EBA considers it preferable to consider non-EEA currencies in the light of the assessments of constraints on the availability of liquid assets as performed by the relevant non-EEA jurisdiction itself.

To determine the supply of liquid assets, the EBA collected data from the Member States using the Basel definition of high-quality liquid assets (HQLA), as laid down in *Basel III: The Liquidity Coverage Ratio and liquidity monitoring tools*, January 2013 (the Basel rules text). The incorporation of the Basel

rules definition is deemed necessary because a definition of liquid assets is not yet established within the context of the CRR. It naturally follows that the list of currencies with constraints on the availability of liquid assets produced by the EBA will have to be revised once a final definition of liquid assets at EU level has been developed and adopted by a delegated act from the Commission by 30 June 2014 in accordance with Article 460. The analysis will be repeated on a regular basis.

On the demand side, the Member States reported the estimated demand for liquid assets from institutions regulated by the CRR as the weighted net cash outflows over the next 30 days, taking into account the cap on inflows as specified in the Basel rules. It should be noted in this regard that these estimates could exceed the demand for liquid assets resulting from the CRR due to an exclusion from the inflow cap of inflows referred to in Article 425(1) CRR. Under the ITS on supervisory reporting, for liquidity coverage requirements issued under Article 415(3)(a) CRR this information will be collected from 2014 onwards.

In the absence of a mandatory reporting requirement prior to the application of the CRD IV/CRR, estimated demand is based on information reported in the EBA's voluntary reporting exercise and/or in the Quantitative Impact Study of the Bank for International Settlements (BIS). The latest reported information available during the assessment process was dated September 2012, so estimated demand does not reflect the changes in the Basel rules text from January 2013 or any possible behavioural effects that may materialise only once the liquidity coverage requirement is in place. For countries that have not participated in the BIS Quantitative Impact Study, the reporting of demand has been based on other available sources. To assess the amount of liquid assets locked up by investors not regulated by the CRR, the Member States reported holdings of liquid assets by these entities, and have provided evidence that these holdings are price-inelastic and stable.

To ensure the robustness of the results, a sensitivity analysis has been conducted to account for uncertainties in the supply and demand figures. The analysis estimated, inter alia, the impact of potential deviations from the Basel rules definition of liquid assets and of scenarios in which the supply of government debt would grow. These analyses helped inform the EBA in its view that the abovementioned approach leads to appropriately robust results.

To keep the ITS up to date, the EBA will repeat its analysis whenever a change (or series of changes) occurs that is likely to have a major impact on the outcome. Such an event may include a material change in the outstanding amount of liquid assets (e.g. government bonds), the amount of assets locked up by institutions not subject to the CRR, or the aggregate net outflows of institutions subject to the CRR. In any case, the analysis will be repeated after the EU Commission has established the calibration of the liquidity coverage requirement by a delegated act.

Following the closure of the consultation on 22 December 2013, the EBA will assess the responses received and consider whether any changes should be made to the draft ITS.

The EBA must submit the draft ITS to the Commission by 31 March 2014.

3. Background and rationale

Background and regulatory approach followed in the draft ITS

In January 2013, the Basel Committee on Banking Supervision (BCBS) published its text of the revised Liquidity Coverage Ratio (LCR) ⁽¹⁾. The objective of the LCR is to promote the short-term resilience of the liquidity risk profile of banks. It does this by ensuring that banks have an adequate stock of unencumbered high-quality liquid assets HQLA that can be converted into cash easily and immediately in private markets to meet their liquidity needs for a 30-calendar-day liquidity stress scenario. It is intended that the LCR will improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source, thus reducing the risk of spillover from the financial sector to the real economy.

The BCBS identified that some jurisdictions may have an insufficient supply of HQLA in their domestic currency to meet the aggregate demand of banks with significant exposures in this currency. To address this situation, alternative treatments for holdings in the stock of HQLA may be applied to a limited number of currencies and jurisdictions. It is envisaged that eligibility for such alternative treatment will be based on meeting a set of qualifying criteria and will be determined through an independent peer review process overseen by the BCBS.

The CRR provisions relating to liquidity coverage requirements translate these BCBS proposals into EU law. The draft ITS as put forward by the EBA for this consultation are a direct result of the CRR provisions.

In accordance with Article 419(1) CRR, the EBA will assess the availability for institutions of assets of extremely high liquidity and credit quality, as defined in Article 416(1)(b), in the currencies that are relevant for institutions established in the Union. The purpose of this consultation in accordance with Article 419(4) is for the EBA to develop draft ITS listing the currencies with constraints on the availability of liquid assets, which will be submitted to the Commission by 31 March 2014. While not the specific purpose of this consultation, the EBA is also to develop an RTS under Article 419(5) CRR to specify derogations referred to in paragraph 2 of that article, including the conditions of their application for currencies with constraints on the availability of liquid assets and listed in this ITS. The ITS and RTS, adopted under Article 419(4) and 419(5) respectively, will have to be read in conjunction with each other.

The ITS in this consultation paper develop the list of currencies where the justified needs for liquid assets emanating from the liquidity coverage requirement in Article 412 CRR exceed the availability of those liquid assets in a currency. In this situation, one or more derogations may be applied. The derogations provide that:

- the denomination by currency of the liquid assets may be inconsistent with the distribution by currency of liquidity net outflows by derogation to Article 417(f);
- for currencies of a Member State or third countries, required liquid assets may be substituted by credit lines from the central bank of that country, which are contractually

⁽¹⁾ <http://www.bis.org/publ/bcbs238.htm>

irrevocably committed for the next 30 days and are fairly priced, provided that the competent authorities of that Member State or third country do the same and that Member State or third country has comparable reporting requirements in place.

In addition to providing a list of currencies, the annex of the draft ITS also estimates shortfall percentages for these currencies as derived from the data-gathering exercise. These percentages indicate the estimated aggregate shortage compared with the aggregate demand generated by the liquidity coverage requirement for each currency in the list. In accordance with Article 419(3), the use of derogations for these currencies shall be inversely proportional to the availability of the relevant assets. To ensure that derogations are applied in this manner, the RTS developed under Article 419(5) CRR will specify a usage limit for the derogations that equals the shortfall percentage. Therewith, the aggregate estimated shortfall in liquid assets can be offset by allowing each institution to cover its individual net outflows by means of the derogation up to a limit emanating from the shortfall percentage.

Process of data collection

In the draft ITS, the list of currencies has been specified on the basis of data gathered by the Member States and a set of assumptions that result in shortage estimates per currency. The data collection process has been completed for two currencies, namely the Norwegian krone (NOK) and the Danish krone (DKK). All the EU Member States had the opportunity to complete an assessment of whether or not there were constraints on the availability of domestic currency liquid assets, to determine the inclusion of their domestic currency in the ITS. However, for currencies other than NOK and DKK a data-gathering exercise was either not pursued or completed for various reasons, primarily relating to the insufficiency of available domestic currency liquid assets or, in limited circumstances, because robust data and documentation to support such an analysis could not be obtained.

Currencies outside the EEA have not been included in the current evaluation, due to, inter alia, the need to focus on the most relevant currencies and constraints to data availability. In particular, estimates of the demand for liquid assets that the implementation of the Basel III liquidity coverage requirement would create for non-EEA jurisdictions are not easily available. In addition, the EBA considers it preferable to consider non-EEA currencies in the light of the assessments of constraints on the availability of liquid assets as performed by the relevant non-EEA jurisdiction itself.

To determine the supply of liquid assets, on the basis that the definition of liquid assets is not yet established within the context of CRR, the EBA decided to proceed using the Basel definition of high-quality liquid assets ("HQLA), as laid down in *Basel III: The Liquidity Coverage Ratio and liquidity monitoring tools*, January 2013 (the Basel rules text). It naturally follows that the list of currencies with constraints on the availability of liquid assets produced by the EBA will have to be revised once a final definition of liquid assets at EU level has been developed and adopted by a delegated act by the Commission by 30 June 2014, in accordance with Article 460.

The Member States reported the outstanding amounts (supply) of level 1, level 2a and level 2b assets, according to the specifications laid down in paragraphs 50–54 of the Basel rules text and sub-categorised by type of issuer and credit quality. The part of supply of these assets that was traded in large, deep and active repo markets was reported separately for each item.

Regarding the demand for liquid assets, the Member States reported the estimated demand for liquid assets from institutions regulated by the CRR as the weighted net cash outflows over the next 30 days, taking into account the cap on inflows as specified in the Basel rules. It should be noted in this regard that these estimates could exceed the demand for liquid assets resulting from the CRR due to an exclusion from the inflow cap of inflows referred to in Article 425(1) CRR. Under the ITS on supervisory reporting, this information for liquidity coverage requirements issued under Article 415(3)(a) CRR will be collected from 2014 onwards.

In the absence of a mandatory reporting requirement before the application of the CRD IV/CRR, demand has been estimated based on information reported in the EBA's voluntary reporting exercise and/or in the Quantitative Impact Study of the Bank for International Settlements (BIS). Since the latest reported information available during the assessment process was dated September 2012, estimated demand does not reflect the changes in the Basel rules text from January 2013 or any behavioural effects that may materialise only once the liquidity coverage requirement is in place. For countries that have not participated in the BIS Quantitative Impact Study, the reporting of demand has been based on other available sources.

For investors not regulated by the CRR, the Member States reported the holdings of liquid assets that show price inelasticity and have proved to be stable.

Finally, Member States provided documentation in support of the figures and to produce an analysis of factors likely to affect the shortfall in liquid assets over a 3- to 5-year period.

Input data for currencies in the list

Norway

For Norway, the total outstanding amount of government debt at September 2012 was approximately NOK 500 billion (500 000 million). The Norwegian government debt market is assessed as being liquid.

International institutions and multinational development banks have issued large amounts of bonds in NOK. The total outstanding of these comes to some NOK 100 billion. However, these issues are predominantly private placements held by overseas investors and are therefore not considered liquid and available for institutions regulated by CRR.

In 2007 Norway passed a covered bond act. Since then, this market has grown considerably in size and now amounts to roughly NOK 400 billion. The market is still developing, but at present there is little trading taking place and the bonds are therefore not deemed to be liquid.

The Norwegian equity market is of a significant magnitude with a market cap of roughly NOK 1 200 billion (excluding equities issued by financial entities). The equities are traded actively outright and in repo markets.

Norway has liquidity reporting in place that resembles the Basel 2010 liquidity requirements covering all Norwegian banks. Norway therefore has significant data to substantiate the estimate of the demand for liquid assets in NOK by institutions subject to the CRR.

Denmark

For Denmark, the total outstanding amount of government debt amounted to DKK 850 billion by September 2012. The Danish government debt market is assessed as being liquid.

The Danish mortgage sector is by far the largest covered-bond-issuing sector. The total outstanding amount of covered bonds is just short of DKK 2 500 billion, of which more than DK 2 100 billion are AAA-rated. The Danish mortgage bonds are traded to a substantial degree and assessed as being liquid for the purposes of this assessment.

The market capitalisation of the constituents of the primary Danish equity index, excluding financials, is just under DKK 1 000 billion. The assumption has been made that holdings by large owners (of more than DKK 500 million) are not tradable, leading to a tradable amount of roughly DKK 700 billion. In the case of Denmark, however, the availability of equity seems to be largely irrelevant for the end results, given the large amount of highly rated covered bonds as indicated above.

Denmark has liquidity reporting in place and participates in the EBA voluntary monitoring exercise. Therefore, it has significant data to substantiate the estimate of the demand for liquid assets in DKK.

Methodology

In formal terms, currencies face constraints on the availability of liquid assets if:

$$(1) \quad A < D + B$$

where A is the availability to institutions of assets that are of extremely high and high liquidity and credit quality, D is the total demand for liquid assets generated by the liquidity coverage requirement as stipulated in Article 412 CRR, and B is a buffer – an excess supply of available liquid assets needed for markets to remain liquid and well functioning after the introduction of the liquidity coverage requirement, expressed as a percentage of demand. The assessment provides an estimate of the amount of free-floating assets required for a market to remain liquid, namely 25% of the total demand for liquid assets generated by the liquidity coverage requirement: $B = 0.25 * D$. This size of the buffer of free-floating assets is seen by the EBA as sufficient for institutions to be able to sell liquid assets in case of stress.

Explanatory notes and question for consultation

The advantage of the buffer (B) as a percentage of demand facilitates a straightforward application to an institution's own demand for liquid assets. An alternative method may be to calculate B by applying a percentage to the gross supply of assets, which may be somewhat more precise, but at the same time more complicated. A more fundamental question is whether this relationship is linear to begin with.

In setting the percentage at 25%, the EBA considered that the necessity for a market to have a significant percentage of assets not locked up is probably greater for small markets than for large ones. The supply of Basel level 1-type liquid assets in currencies with insufficient liquid assets consists of relatively small/medium-sized markets; therefore, the EBA opted not to set the assumption regarding the buffer too low. On the other hand, it may not be beneficial to go beyond 25%, as there may be assets for which supply-side liquidity may be guaranteed, thus decreasing the size of the buffer necessary to keep markets liquid. Furthermore, a more general consideration is that the determination of the shortfall (in these ITS) does not take into account the phase-in arrangements for the liquidity coverage requirement provided for in the CRR. The shortfall estimated may, therefore, be lower in practice, depending on how the phase-in arrangements are implemented at national level.

Q1: Do you agree with the method for estimating the level of free-floating assets required for a market to remain liquid? If not, what alternative methodology would you suggest and what percentage would you deem appropriate? Please substantiate your response.

The availability to institutions of assets that are of extremely high and high liquidity and credit quality (A) can be expressed as:

$$(2) \quad A = \sum A(i) = \sum \sum (O(i) - L(i,j))$$

where $A(i)$ is availability for institutions of liquid asset i , $O(i)$ is outstanding amount of asset i and $L(i,j)$ is amount locked up of asset i by sector j .

Generally, the assets held by pension funds, insurance companies and central banks have been assumed to be 100% locked up.

Specifically for Norway, it has been observed that roughly one fifth of the government debt is held by foreign investors that are dominated by central banks and other buy-and-hold investors, amounting to roughly NOK 105 billion of government debt locked up. In terms of equity, the amount locked up by foreign investors amounts to roughly NOK 80 billion. The demand for liquid assets from Norwegian non-CRR-regulated parties is negligible.

Denmark has a fully funded pension system that, historically, has invested significantly in Danish government bonds. The total holdings of the pension and insurance sector, including the Danish Social Pension Funds, amount to some 40% of total outstanding government debt, amounting to roughly DKK 340 billion. The pension system investments in covered bonds are assumed to amount to roughly DKK 200 billion. Foreign investors, of which foreign central banks constitute a very significant part, hold nearly 20 % of the outstanding government debt, amounting to roughly DKK 125 billion. Foreign holdings of DKK-denominated covered bonds are found to be negligible.

Question for consultation

Q2: Are the assumptions regarding locked-up assets reasonable and, if not, what alternative assumptions should be made? Please substantiate your response.

The total demand for liquid assets generated by the liquidity coverage requirement as stipulated in Article 412 CRR (D) may be expressed as follows:

$$(3) \quad D = \sum cD(k)$$

where $D(k)$ is the demand from institution k when liquidity coverage requirement = 1, and c is a constant equal to or larger than 1, reflecting the fact that institutions may hold liquid assets in excess of the minimum requirement.

The assumption is that institutions aim to maintain, on average, a liquidity coverage requirement of 110%, which implies that c in the above formula is set at 1.1. Institutions may aim for a liquidity coverage requirement of above 100% because of, inter alia, uncertainty regarding future inflows and outflows as well as fluctuations in the market value of the liquidity buffer.

On the basis of the abovementioned data and assumptions, the EBA's assessment provided estimates of the shortfall in available liquid assets relative to the demand from institutions regulated by the CRR, that is: $(1 + (B - A)/D) * 100 \%$.

Explanatory notes and question for consultation

There are several reasons why institutions may hold liquid assets in excess of the minimum requirement. In particular, uncertainty regarding future inflows and outflows and fluctuations in the market value of the liquidity buffer provide a prudent justification for institutions to hold a liquidity buffer in excess of the minimum requirement.

Q3: Is 110% a reasonable assumption for an institution's target liquidity coverage requirement? If not, please outline what you deem to be a reasonable assumption regarding an institution's target liquidity coverage requirement. Please substantiate your response.

Results

On the basis of the process and methodology, the EBA has determined that the Norwegian krone (NOK) and Danish krone (DKK) are currencies with constraints on the availability of liquid assets. Specifically, the available liquid assets denominated in NOK are estimated to be 62% of the aggregate demand for liquid assets denominated in NOK from institutions, assuming that they target a 110% liquidity coverage requirement. The shortage without taking into account the 25% buffer for keeping markets liquid equates to 38%, that is $100\% - 62\%$. Incorporating the 25% buffer would result in a 63% shortage of NOK compared with the aggregate demand for NOK-denominated liquid assets.

For DKK, the available liquid assets are estimated to be 98% of the aggregate demand for liquid assets denominated in DKK from institutions, assuming that they target a 110% liquidity coverage requirement. The shortage without taking into account the 25% buffer for keeping markets liquid will then be $100\% - 98\% = 2\%$. Incorporating the 25% buffer would result in a 27% shortage in DKK compared with the aggregate demand for DKK-denominated liquid assets.

Sensitivity analysis

To take into account uncertainties in the supply and demand figures for liquid assets, a sensitivity analysis has been conducted by shocking the various input variables. The analysis estimated, inter alia, the impact of potential deviations from the Basel rules definition of liquid assets, and of scenarios in which the supply of government debt would grow. These analyses helped support the EBA in its view that the abovementioned approach leads to appropriately robust results. Clearly, however, the results are significantly sensitive to the estimates and parameter values used in the methodology, in particular the assumptions that a buffer of 25% of demand is necessary for markets to remain liquid and that institutions target a 110% liquidity coverage requirement on average.

For Norway, in all the general scenarios, the availability of liquid assets falls well short of the demand from institutions, resulting in ratios ranging from a low of 47% to a high of 83% of available liquid assets as a percentage of demand for liquid assets. Further specific scenarios for Norway were also considered. First, the amount of issuance from international organisations and international development banks was assumed to be liquid and available to institutions. In this case, the ratio increases to 79%. The second scenario specific to Norway assumed a 40% cap on level 2b assets. In this case, the ratio rose to 88%, reflecting the considerable size of the Norwegian equity market.

Other scenarios considered include a change to the definition of level 1 assets to include the highest rated covered and corporate bonds, and changes to the cap on level 1 assets. These had no significant impact on the Norwegian case, as the highest-rated covered and corporate bonds in Norway are not assessed as being liquid. This assessment may however change depending on the European definition of asset liquidity, which may take into account supply-side liquidity.

For Denmark, the general scenario analysis shows the availability of liquid assets relative to the demand from institutions regulated by the CRR to be fluctuating around 100%, with the lowest ratio 74% and the highest 133%. Given the high ownership of government bonds by the pension and insurance sector, the ratio is clearly sensitive to changes in this figure, as is demonstrated in the first scenario specific to DKK. Here it is assumed that these holdings are reduced by 50%, and the ratio increases to 168%. Another scenario specific to Denmark assumes that the supply of government bonds is increased by DKK 50 billion in line with official projections for 2015. In this case, the ratio increases to 111%.

The scenario analysis also contains three scenarios analysing the consequences of applying a different definition of liquid assets as well as a different level of the cap on level 2 assets. If the cap on level 2 assets is raised from the 40% prescribed by the Basel rules to 60%, the ratio increases to 148%. If there is no cap on level 2 assets or if the highest-rated covered and corporate bonds are deemed level 1 assets, the ratio increases to 357% or 400%, respectively. The high sensitivity to these scenarios is related to the large size of the Danish covered bond market, which under the current Basel rules definition is capped at 40% of the buffer.

To keep the ITS updated, the EBA will repeat its analysis whenever a change (or series of changes) occurs that is likely to have a major impact on the outcome. Such an event may include a material change in the outstanding amount of liquid assets (e.g. government bonds), the amount of assets locked up by institutions not subject to the CRR, or the aggregate net outflows of institutions subject to the CRR. In any case, the analysis will be repeated after the COMM has established the calibration of the liquidity coverage requirement by delegated act.

Question for consultation

Q4: Do you agree with the general approach and its results?

Timing of ITS development and application date

The EBA intends to finalise the draft ITS and endorse it for submission to the Commission by 31 March 2014.

4. Draft implementing technical standards on currencies for which the justified demand for liquid assets exceeds the availability of those assets under Article 419(4) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)

Between sections of the text of the draft ITS that follows, further explanations on specific aspects of the proposed text are occasionally provided, which offer examples or provide the rationale behind a provision, or set out specific questions for the consultation process. In such cases, this explanatory text appears in a framed text box.

Contents



EUROPEAN COMMISSION

Brussels, **XXX**
[...] (2013) **XXX** draft

COMMISSION IMPLEMENTING REGULATION (EU) No .../..

of **XXX**

[...]

COMMISSION IMPLEMENTING CRR laying down implementing technical standards with regard to currencies with constraints on the availability of liquid assets according to Regulation (EU) 575/2013 of the European Parliament and of the Council

of **XXX**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 575/2013 of 26 June 2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms², and in particular Article 419(4) thereof,

Whereas:

- (1) This Basel Committee on Banking Supervision has established international standards regarding the liquidity coverage ratio and liquidity risk monitoring tools (the BCBS standards). The BCBS standards establish guiding principles for assessing availability for institutions of liquid assets in currencies. In line with Principle 1 of the BCBS Standards, only currencies for which sufficient evidence is demonstrated should be listed, and secondly, a methodology which takes into account all relevant factors affecting the supply of, and demand for liquid assets, should be established. Pursuant to Annex II of the BCBS Standards, the methodology should take into account factors relating to the supply of liquid assets, the market for liquid assets, the demand for liquid assets by institutions, and demand for liquid assets by entities outside of the scope of Regulation (EU) 575/2013.
- (2) In order to ensure that use of the derogations in Article 419 of Regulation (EU) 575/2013 is inversely proportional to the availability of the relevant assets it is necessary to list for each relevant currency the amount by which justified needs for liquid assets exceed availability.
- (3) Pending the adoption of a harmonised Union definition of what constitutes a liquid asset, the determination of a constraint on the availability of liquid assets should be based on the definition of high quality liquid assets adopted by the Basel Committee on Banking Supervision.
- (4) The assessment of justified needs should be based on the amounts of liquid assets outstanding within the currencies that are not locked-up by entities not subject to the Regulation (EU) 575/2013 and be compared to institutions' estimated weighted net cash outflows over the next 30 days, taking into account the cap on inflows and factors likely to affect the shortage of liquid assets over a 3 to 5 year period. The assessment

² OJ. 176, 27.6.2013, p.1.

should also take into account the need for institutions to be able to sell liquid assets in case of stress and should therefore provide for a buffer of 25% of estimated demand. Additionally the assessment should take into account the propensity of institutions to target a liquidity coverage requirement of above 100%, such as 110%.

- (5) The assessment should be based on the best available data that can be supplied by competent authorities to the European Supervisory Authority (European Banking Authority) (EBA) on liquid assets in a currency, locked-up amounts and institutions' liquid assets demands.
- (6) This Regulation is based on the draft implementing technical standards submitted by the EBA to the Commission.
- (7) The EBA has conducted open public consultations on the draft implementing technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010,

HAS ADOPTED THIS REGULATION:

Article 1 – Currencies with constraints on availability of liquid assets

For the purpose of Article 419(2) of Regulation (EU) 575/2013, the justified needs for liquid assets in light of the requirement in Article 412 of that Regulation exceed the availability of those liquid assets in the currencies specified in the table in the Annex by the amount specified in that table.

Article 2 – Final provisions

This Regulation shall enter into force on the the twentieth day following that of its publication in the Official Journal of the European Union.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission

The President

On behalf of the President

[Position]

ANNEX

Currency	Amount by which justified needs for liquid assets exceed availability
Danish Krone (DKK)	27%
Norwegian Krone (NOK)	63%

5. Accompanying documents

5.1 Draft cost-benefit analysis / impact assessment

5.1.1 Introduction

1. Article 15(1) of the EBA Regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council) provides that when any draft implementing technical standards developed by the EBA are submitted to the Commission for adoption, they shall be accompanied by an analysis of 'the potential related costs and benefits'. This analysis should provide an overview of the findings regarding the problem to be dealt with, the solutions proposed and the potential impact of these options.
2. This note outlines the assessment of the impact of the draft ITS regarding currencies for which the justified demand for liquid assets exceeds the availability of those assets. The development of the draft ITS stems from the requirement set out in Article 419(4) CRR.

5.1.2 Problem definition

Issues addressed by the European Commission (EC) regarding liquidity management

3. In its impact assessment of the CRD IV framework, the European Commission noted that the existing liquidity risk management approaches and supervisory regimes inadequately captured risks inherent in the underlying market practices and trends. These shortcomings contributed to the failure of several institutions and strongly undermined the financial health of many others, threatening financial stability and leading to unprecedented levels of central bank liquidity and government support.
4. To address this issue, the CRR proposes two minimum standards for funding liquidity. One of these requirements is the Liquidity Coverage Ratio (LCR), which aims to ensure that an institution has sufficient high-quality liquid resources (HQLA) to survive an acute stress scenario lasting for 30 days. This requirement will contribute to achieving the general objectives of the CRD IV, as well as the two following specific objectives:
 - ▶ S.1 Enhancing adequacy of capital and liquidity requirements
 - ▶ S.2 Enhancing bank risk management
5. To meet the liquidity coverage requirement, institutions must hold a stock of HQLA to cover the total net cash outflows over a 30-day period. Such assets should be liquid in markets during a time of stress and, in most cases, be eligible for use in central bank operations. Because in some jurisdictions there may not be enough HQLA available, the CRR leaves a possibility for institutions to use derogations to meet their liquidity coverage requirement in the line of what has been suggested in the Basel III framework.

Issues addressed by the technical standard and objectives

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6. The CRR mandates the EBA to develop draft ITS listing the currencies with constraints on the availability of liquid assets. For all the currencies listed, the derogations to the liquidity coverage requirement set out in Article 419(2) CRR shall apply.

Technical option chosen

7. The EBA has developed a methodology based on the comparison of the estimated demand and supply of liquid assets to establish in which currencies a shortfall in liquid assets may exist. The EBA has established that a buffer of free-floating assets of 25% would be appropriate to maintain a sufficient level of liquidity in the financial markets considered.

5.1.3 Impact

Costs

8. These ITS list the currencies for which the EBA has identified that there may be a constraint on the availability of liquid assets and for which institutions can apply the derogation allowed in Article 419(2) CRR. The process of determining eligibility for the list builds on data available at the national supervisory authorities and will not raise additional costs for institutions.
9. The EBA has currently identified only two EU currencies for which the availability of liquid assets is less than their justified demand. The number of institutions operating in these currencies is also small and the amount of total assets that they hold represents only a small share of the total assets held by the banking sector in the EEA. The risk of creating an uneven playing field for the application of the liquidity coverage requirement is therefore small.

Benefits

10. The pre-set methodology by which these ITS have been determined will ensure that currencies with a shortfall in liquid assets are identified on a consistent basis. It will ensure that institutions operating in these currencies may use, when appropriate, the derogations to the liquidity coverage requirement to meet their liquidity requirements. The assumption that a buffer of free-floating assets of 25% is necessary to help ensure that the liquidity coverage requirement requirements do not impede the liquidity of the financial markets in which they operate.

Question for consultation

Q5: Do you agree with the above analysis of the cost and benefit impact of the proposals?

5.2 Overview of questions for consultation

Q1: Do you agree with the method for estimating the level of free-floating assets required for a market to remain liquid? If not, what alternative methodology would you suggest and what percentage would you deem to be appropriate? Please substantiate your response.

Q2: Are the assumptions regarding locked-up assets reasonable and, if not, what alternative assumptions should be made? Please substantiate your response.

Q3: Is 110% a reasonable assumption for an institution's target liquidity coverage requirement? If not, please outline what you deem to be a reasonable assumption regarding an institution's target liquidity coverage requirement. Please substantiate your response.

Q4: Do you agree with the general approach and its results?

Q5: Do you agree with the above analysis of the cost and benefit impact of the proposals?