



EBA/RTS/2014/04

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EBA FINAL draft regulatory technical standards

On derogations for currencies with constraints on the availability of liquid assets under Article 419(5) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)

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Abbreviations

BCBS	Basel Committee on Banking Supervision
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
ITS	Implementing Technical Standard
LCR	Liquidity Coverage Ratio
RTS	Regulatory Technical Standard

1. Executive summary

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

The CRR contains specific mandates in a number of different articles 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 rule book' enhancing regulatory harmonisation in the European Union.

Main features of the RTS

In these final draft RTS the EBA specifies, pursuant to Article 419(5) of the CRR, the derogations referred to in Article 419(2) of the CRR, including the conditions of their application. In accordance with that Article, either or both of the derogations shall apply for those currencies with constraints on the availability of liquid assets listed in the ITS pursuant to Article 419(4) of the CRR. For those currencies, the justified need for liquid assets in light of the liquidity coverage requirement in Article 412 of the CRR exceeds the availability of liquid assets. The derogations are intended to address the inherent difficulties that institutions would face in meeting their liquidity coverage requirement in those currencies where, despite sound liquidity management, it is not possible to reduce the need for those liquid assets and the holdings of those assets by other market participants.

If appropriate, institutions can choose to apply one or more of the two derogations pursuant to Article 419(2) of the CRR, of which the first (derogation A) allows the use of liquid assets denominated in a foreign currency, and the second (derogation B) allows the use of credit lines committed by the relevant central bank as liquid assets. In the draft RTS, these derogations, and the conditions for their application, have been specified with the following overarching objectives in mind. First, the application of a derogation should not be advantageous to the extent that, while it corrects for a disproportionate impact, it would lead to an uneven playing field between institutions. Second, the application of a derogation should not lead to undue risks for an institution. Third, the use of a derogation should be limited, and – in accordance with Article 419(3) of the CRR – inversely proportional to the availability of the relevant assets.

For these reasons, the draft RTS restricts the use of any derogation by requiring institutions to, firstly and continuously, seek to reduce their need for a derogation. Such reduction measures should include better management of the inflow cap, prudent changes in liquidity management or renewed efforts to acquire liquid assets in the domestic currency. A derogation can be applied only in circumstances where an institution demonstrates that all of these steps have been taken and the justified need for the liquid assets remains.

Further measures to prevent unnecessary use of a derogation by institutions are embedded in the operation of the two derogations provided for in these RTS. In this regard, under derogation A, a general additional 8% haircut has to be applied to foreign currency liquid assets held to meet domestic currency net outflows to adjust for currency risk. This additional haircut can be lower in case of a mutually supported currency peg and higher in case of a non-global currency. Under derogation B, the associated fees to be paid by institutions to the Central Bank should offset the higher yield earned on the assets kept to secure the credit lines and, if applicable, also incorporate a charge reflective of the amount drawn down.

More generally, the application of one or more of the derogations by an institution will require that mitigating action be taken to address potential risks arising from the use of derogations. Institutions should have the capacity through mechanisms or controls to limit or mitigate the risk of unintended consequences from the use of these derogations. An integral part of supervisory review means that institutions will have implemented mechanisms to monitor, disclose and assess the need for and use of these derogations.

The draft RTS also contain a limit to the total use of the derogations by institutions, which equals the relevant shortfall percentage in the annex of the ITS containing a list of currencies with constraints on liquid assets under Article 419(4) of the CRR. These percentages indicate the estimated aggregate shortfall compared to the aggregate demand generated by the liquidity coverage requirement for each currency on the list. The EBA's view is that 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 the aforementioned percentage. In that way, the use of derogations is inversely proportional to the availability of assets of high or extremely high liquidity and credit quality such as is prescribed by Article 419(3) of the CRR.

The process by which institutions apply derogations is underpinned by a notification requirement to provide competent authorities with detailed information 30 days prior to the initial use of the derogation or of a material change to current usage. Additionally, the use of derogations A and B will be reported in the ITS in compliance with the liquidity coverage requirement reporting formats set out under Article 415(3) of the CRR.

The EBA assessed the responses received once the consultation had closed on 22 December 2013. This assessment led to the conclusion that no changes should be made to the version of the draft RTS on which the consultation had been based.

The EBA has submitted the draft RTS to the European Commission.

2. Background and rationale

The nature of RTS under EU law

The present draft RTS are produced in accordance with Article 10 of the EBA regulation (). In accordance with Article 10(4) of the EBA regulation, RTS shall be adopted by means of a regulation or decision.

According to EU law, EU regulations are binding in their entirety and directly applicable in all Member States. This means that, on the date of their entry into force, they become part of the national law of the Member States and that their implementation into national law is not only unnecessary but also prohibited by EU law, except in so far as this is expressly required by them.

The RTS are in the form of a regulation to ensure harmonisation of the liquidity requirements and a level-playing field. This entails that the derogations applicable under Article 419(2) of the CRR are available in all the relevant Member States and are subject to the same conditions.

Background and regulatory approach followed in the draft RTS

In January 2013, the Basel Committee on Banking Supervision (BCBS) published a revised text of its rules on the 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 easily and immediately in private markets into cash 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 related to liquidity coverage requirements translate these BCBS proposals into EU law. The draft RTS as developed and finalised herein are a direct result of the CRR provisions.

¹ Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools - <http://www.bis.org/publ/bcbs238.htm>

In accordance with Article 419(1) of the 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) of the CRR in the currencies that are relevant for financial institutions in the Union. In parallel with the development and finalisation of these final draft RTS, the EBA has developed and finalised the draft ITS listing the currencies with constraints on the availability of liquid assets, in accordance with Article 419(4) of the CRR. The ITS and RTS, adopted under Articles 419(4) and 419(5) of the CRR respectively, will have to be read in conjunction with each other.

The purpose of the final draft RTS is to provide details of the derogations referred to in Article 419(2) of the CRR, including the conditions of their application, where the justified needs for liquid assets emanating from the liquidity coverage requirement in Article 412 of the CRR exceed the availability of those liquid assets in a certain 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 point (f) of Article 417 of the CRR;
- 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 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 the draft RTS, these derogations, and the conditions for their application, have been specified with the following overarching objectives in mind. First, the application of a derogation should not be advantageous to the extent that, while it corrects for a disproportionate impact, it would lead to an uneven playing field between institutions. Second, the application of a derogation should not lead to undue risks for an institution. Third, the use of a derogation should be limited and – in accordance with Article 419(3) of the CRR – inversely proportional to the availability of the relevant assets.

For these reasons, the draft RTS restricts the use of any derogation by requiring institutions to reduce their need for it, such as by a better management of the inflow cap, changes in liquidity management or renewed efforts to acquire liquid assets in the domestic currency. Only if an institution demonstrates that all of these steps have been taken, and the insufficiency remains, can a derogation be applied.

Further measures to prevent unnecessary use by institutions are embedded in the operation of the two derogations provided for in these RTS. Under derogation A, a general additional 8% haircut has to be applied to foreign currency liquid assets held to meet domestic currency net outflows to adjust for currency risk. This additional haircut can be lower in case of a mutually supported currency peg and higher in case of a non-global currency. Under derogation B, the

associated fees to be paid by institutions should offset the higher yield earned on the assets kept to secure the credit lines and, if applicable, also incorporate a charge reflective of the amount drawn down.

More generally, the application of one or more of the derogations by an institution will require that mitigating action be taken to address potential risks arising from the use of derogations. Institutions should have the capacity through mechanisms or controls to limit or mitigate the risk of unintended consequences from the use of these derogations. An integral part of supervisory review means that institutions will have implemented mechanisms to monitor, disclose and assess the need and use of these derogations.

The draft RTS also contain a limit to the total use of the derogations by institutions, which equals the relevant shortfall percentage in the annex of the ITS containing a list of currencies with constraints on liquid assets under Article 419(4) of the CRR. These percentages indicate the estimated aggregate shortfall compared to the aggregate demand generated by the liquidity coverage requirement for each currency on the list. The EBA's view is that 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 the aforementioned percentage. In that way, the use of derogations is inversely proportional to the availability of assets of high or extremely high liquidity and credit quality such as is prescribed by Article 419(3) of the CRR.

The process by which institutions apply derogations is underpinned by a notification requirement, to provide competent authorities with detailed information 30 days prior to the initial use of the derogation or of a material change to current usage. Additionally, the use of derogations A and B will be reported in the ITS in compliance with the liquidity coverage requirement reporting formats set out under Article 415(3) of the CRR.

The EBA has conducted further work in this area. In accordance with the report to the Commission under Article 509 of the CRR to assess the implications of introducing liquidity coverage requirements in the EU, the EBA assessed, under point (h) of paragraph 2 of that Article, the derogations from requirements on the composition of the liquid assets that institutions will be required to hold, where in a given currency the institutions' collective justified needs for liquid assets exceed the availability of those liquid assets and conditions such derogations should be subject to. The first report was submitted to the Commission in December 2013 and is available on the EBA's website. On the basis of this report, the Commission's delegated act adopted to introduce liquidity coverage requirements under Article 460 of the CRR may lead to amendments in the workings of the derogations. More specifically, the delegated act might introduce a cap on the amount of assets of high liquidity and credit quality reported under Article 416(1)(d) of the CRR that are recognised in the liquidity buffer. A further derogation relating to the additional use of these assets of high liquidity and credit quality with more stringent haircuts could, therefore, be introduced to address constraints on available assets of extremely high liquidity and credit quality that may arise from the application of the cap. This would be similar to what the BCBS standard terms 'Option 3', namely the additional use of Level 2 assets with more stringent haircuts.

3. EBA final regulatory technical standards on derogations for eligible currencies under Article 419(5) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)



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

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

of **XXX**

COMMISSION DELEGATED REGULATION (EU) No .../...
supplementing Regulation (EU) No 575/2013 of the European Parliament and of the
Council with regard to regulatory technical standards to specify the derogations
concerning currencies with constraints on the availability of liquid assets

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

Article 419(5) of Regulation (EU) No 575/2013 ('the Regulation') empowers the Commission to adopt, following submission of draft standards by the European Banking Authority (EBA), and in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010, delegated acts specifying the derogations referred to in Article 419(2) of the Regulation concerning currencies with constraints on the availability of liquid assets, including the conditions of their application.

These derogations provide that the denomination of liquid assets may be inconsistent with the distribution by currency of net outflows, and/or liquid assets may be substituted by credit lines from the central bank. 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.

In accordance with Article 10(1) of Regulation (EU) No 1093/2010 establishing the EBA, the Commission shall decide within three months of receipt of the draft standards whether to endorse the drafts submitted. The Commission may also endorse the draft standards in part only, or with amendments, where the Union's interests so require, having regard to the specific procedure laid down in those Articles.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT.

In accordance with the third subparagraph of Article 10(1) of Regulation (EU) No 1093/2010, the EBA has carried out a public consultation on the draft technical standards submitted to the Commission in accordance with Article 423(3) of Regulation (EU) No 575/2013. A consultation paper was published on 22 October 2013 on the EBA internet site, and the consultation closed on 22 December 2013. Moreover, the EBA invited the EBA's Banking Stakeholder Group set up in accordance with Article 37 of Regulation (EU) No 1093/2010 to provide advice on them.

Together with the draft technical standards, the EBA has submitted an explanation on how the outcome of these consultations has been taken into account in the development of the final draft technical standards submitted to the Commission.

As specifically requested by the Commission, only the draft technical standard and explanatory memorandum are submitted to the Commission for adoption. All relevant accompanying information – notably the background and rationale of the draft technical standards, the impact assessment and the feedback on the public consultation – is included in the full version of the technical standards, which was approved by the EBA's Board of Supervisors and will be published on the EBA's public website: <http://www.eba.europa.eu/regulation-and-policy/liquidity-risk/draft-technical-standards-ts-on-currencies-with-constraints-on-the-availability-of-liquid-assets>.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

The provisions of these draft standards set out the derogations, and the conditions for their application, which have been specified with the following overarching objectives in mind. First, the application of a derogation should not be advantageous to the extent that, while it corrects for a disproportionate impact, it would lead to an uneven playing field between institutions. Second, the application of a derogation should not lead to undue risks for an institution. Third, the use of a derogation should be limited, and – in accordance with Article 419(3) of the Regulation – inversely proportional to the availability of the relevant assets.

Article 2 requires as a condition of using a derogation that an institution notify its competent authority of the proposed use, or a material change in use.

Article 3 sets out conditions which must be met for an institution to be considered to have justified needs for liquid assets in the relevant currency.

Article 4 specifies the derogation in point (a) of Article 419(2) of the Regulation. In particular it requires institutions to maintain effective systems which enable use of the derogation to be monitored and controlled, and requires a general additional 8% haircut to be applied to foreign currency liquid assets held to meet domestic currency net outflows to adjust for currency risk. This additional haircut can be lower in the case of a mutually supported currency peg and higher in the case of a currency which is not actively traded in global foreign exchange markets.

Article 5 specifies the derogation in point (a) of Article 419(2) of the Regulation. In particular it specifies conditions which central bank credit lines must meet in order to be used, requires a haircut of 15% to be applied to collateral posted at the central bank, and requires that the associated fees to be paid by institutions to the central bank offset the higher yield earned on the assets kept to secure the credit lines and, where applicable, also incorporate a charge which reflects the amount drawn down.

Article 6 ensures that the use of a derogation is inversely proportional to the availability of the relevant assets by limiting the total use of the derogations by institutions to the percentage specified in implementing technical standards containing a list of currencies with constraints on liquid assets adopted pursuant to Article 419(4) of the Regulation. This constitutes an approach to limiting the use of derogations which is sensitive to the actual shortage identified for that currency.

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

of XXX

**COMMISSION DELEGATED REGULATION (EU) No .../...
supplementing Regulation (EU) No 575/2013 of the European Parliament and of the
Council with regard to regulatory technical standards to specify the derogations
concerning currencies with constraints on the availability of liquid assets**

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 firms and amending Regulation (EU) No 648/2012¹ and in particular Article
419(5) thereof,

Whereas:

- (1) The Basel Committee on Banking Supervision has established international standards regarding the liquidity coverage ratio and liquidity risk monitoring tools² (the BCBS standards).
- (2) To help ensure effective oversight and control of the use of the derogations in Article 419(2) of Regulation (EU) No 575/2013 and effective monitoring of institutions' compliance with the requirements applicable to use of the derogations, in accordance with the BCBS standards, institutions should notify competent authorities of their initial use of the derogations or a material change to their use of the derogations.
- (3) The BCBS standards establish guiding principles for supervisors in jurisdictions with insufficient high quality liquid assets. In line with Principle 3 of those guiding principles for supervisors, the assessment of justified needs should ensure that banks have, to the extent practicable, taken reasonable steps to use high quality liquid assets and reduced their overall level of liquidity risk to improve compliance with the liquidity coverage requirement, before the derogations are applied.
- (4) In line with Principles 1 and 4 of the guiding principles for supervisors, the application of the derogations should ensure that institutions' use of the derogations is not simply an economic choice that maximises the profits of the institution through the selection of alternative high quality liquid assets based primarily on yield considerations and to establish a mechanism for restraining the usage of the derogations to mitigate risks of non-performance of the alternative assets. Appropriate haircuts should be established for the derogation in point (a) of Article 419(2) of Regulation (EU) No 575/2013 and to inform the fee structure

¹ OJ L 176, 27.6.2013, p. 1.

² Basel Committee on Banking Supervision, Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools, January 2013.

for the derogation in point (b) of that Article taking into account the BCBS standards. In particular, under the derogation in point (b) of that Article, in order to ensure fair pricing of central bank credit lines, two fees should be charged. The first should offset the higher yield earned on the assets kept to secure the credit line in order to ensure that the pricing reflects benefits which accrue independent of the amount currently drawn. The second fee should reflect the amount of the credit line drawn down.

- (5) In line with Principle 2 of the guiding principles for supervisors, the use of the derogations should be constrained for all institutions with exposures in the relevant currency. Pursuant to Article 419(3) of Regulation (EU) No 575/2013, such constraints should be inversely proportional to the availability of assets of extremely high or high liquidity and credit quality. For these reasons the use of the derogations should be limited to a percentage of an institution's net liquidity outflows in the relevant currency which corresponds to the relevant shortage in liquid assets in that currency.
- (6) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) (EBA) to the Commission.
- (7) EBA has conducted open public consultations on the draft regulatory 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 of the European Parliament and of the Council,

HAS ADOPTED THIS REGULATION:

Article 1

Subject matter

This Regulation specifies the derogations concerning currencies with constraints on the availability of liquid assets referred to in Article 419(2) of Regulation (EU) No 575/2013.

Article 2

Notification of the use of a derogation

1. An institution shall notify the competent authority of its use of one or more of the derogations referred to in Article 419(2) of Regulation (EU) No 575/2013. The notification shall be provided in writing 30 days before the first use of the derogation and before any material change in the use of the derogation. In exceptional circumstances where it is not possible to provide competent authorities with the notification of a material change within 30 days, institutions shall provide the notification as soon as possible. The notification shall be updated at least annually.
2. The notification shall include the following information:

- (a) whether the institution is using, or intends to use, the derogation in point (a) of Article 419(2) of Regulation (EU) No 575/2013 (hereinafter “derogation A”), the derogation in point (b) of that Article (hereinafter “derogation B”), or both derogations;
- (b) how the institution meets or intends to meet the conditions in Article 419(3) of Regulation (EU) No 575/2013 and the requirements of this Regulation;
- (c) where the institution uses or intends to use derogation A, the details of the calculation of the haircuts specified in Article 4(5);
- (d) where the institution uses or intends to use derogation B, the details of the credit line fee calculation specified in paragraphs 5 to 7 of Article 5;
- (e) an estimate of the institution’s future use of the derogation or derogations including a comparison of the institution’s liquidity position if it uses the derogation or derogations with its liquidity position if it does not make such use;

Article 3

Assessment of justified needs

An institution does not have justified needs for liquid assets for the purpose of Article 419(3) of Regulation (EU) No 575/2013 unless it meets the following conditions:

- (a) it has reduced, by sound liquidity management, the need for liquid assets in the full range of business conducted by the institution;
- (b) its holdings of liquid assets are consistent with the availability of those assets in the relevant currency.

Article 4

Derogation A

1. This Article specifies derogation A.
2. An institution shall take all reasonable steps to fulfil the liquidity coverage requirement in Article 412 of Regulation (EU) No 575/2013 before applying derogation A.
3. An institution shall ensure that it is at all times able to operationally identify liquid assets used to meet foreign currency liquidity coverage requirements and liquid assets held as a result of the application of derogation A.
4. An institution shall ensure that its foreign exchange risk management framework meets each of the following requirements:
 - (a) currency mismatches resulting from the use of derogation A are adequately measured, monitored, controlled and justified;
 - (b) liquid assets which are inconsistent with the distribution by currency of liquidity outflows after the deduction of inflows can be liquidated in the

currency of the Member State of the relevant competent authority whenever necessary including, in particular, in a stress scenario;

- (c) historical evidence relating to stress periods supports the conclusion that the institution is able to promptly liquidate the assets referred to in point (b).
5. An institution which uses liquid assets in a currency other than the currency of the Member State of the relevant competent authority to cover liquidity needs in the latter currency shall apply a haircut of 8% to the value of those assets in addition to any haircut applied in accordance with Article 418 of Regulation (EU) No 575/2013. Where the liquid assets are denominated in a currency that is not actively traded in global foreign exchange markets the additional haircut shall be the higher of 8% or the largest monthly exchange rate movement between both currencies in the ten years prior to the relevant reporting reference date. Where the currency of the Member State of the relevant competent authority is formally pegged to another currency under a mechanism in which the central banks of both currencies are obliged to support the currency peg, the institution may apply a haircut equal to the width of the exchange rate band.

Article 5

Derogation B

1. This Article specifies derogation B.
2. An institution shall take all reasonable steps to fulfil the liquidity coverage requirement in Article 412 of Regulation (EU) No 575/2013 before applying derogation B.
3. An institution shall obtain a credit line from the central bank which meets each of the following conditions:
 - (a) the institution has a legally binding entitlement to access the credit facilities which is supported by a documented agreement;
 - (b) following the decision to provide a credit line, access to the credit facilities is not subject to a credit decision by the central bank;
 - (c) the credit facilities can be drawn on by the institution without delay and no later than one day after giving notice to the central bank;
 - (d) the credit line shall at all times be available for a period which exceeds the 30 day period of the liquidity coverage requirement specified in Article 412(1) of Regulation (EU) No 575/2013.
4. An institution shall fully post collateral at the central bank. The value of the collateral shall be subject to a haircut of at least 15% and shall after applying that haircut, at all times equal or exceed the maximum amount that may be drawn on the credit line.
5. An institution shall pay a fee for the credit line in accordance with a fee structure that is designed not to provide an economic advantage or an economic disadvantage, compared to the position of institutions which do not make use of derogation B.

6. The fee paid by an institution for the credit shall comprise the following fees:
 - (a) a fee which is based on the amount of the credit line drawn down;
 - (b) a fee which approximates the difference between the following amounts:
 - (i) the yield on the assets used to secure the credit line;
 - (ii) the yield on a representative portfolio of assets of the type specified in points (a) to (d) of Article 416(1) of Regulation (EU) No 575/2013.
7. The fee referred to in point (b) of paragraph 6 may be adjusted to take into account any material differences in credit risk between the sets of assets referred to in that point.

Article 6

Maximum level of usage of derogations

1. An institution's use of the derogations in Article 419 of Regulation (EU) No 575/2013 shall not exceed the relevant percentage specified in respect of a currency in implementing technical standards adopted pursuant to Article 419(4) of Regulation (EU) No 575/2013.
2. For the purpose of paragraph 1, the use of the derogations shall be calculated as the percentage that X represents of Y where:
 - (a) "X" is the sum of the value of all liquid assets to which derogation A applies, after application of the haircuts required pursuant to Article 418 of Regulation (EU) No 575/2013 and Article 4(5) of this Regulation, and the maximum amount that may be drawn on a credit line to which derogation B applies;
 - (b) "Y" is the institution's liquidity coverage requirement pursuant to Article 412 of Regulation (EU) No 575/2013.

Article 7

Final provisions

This Regulation shall enter into force on 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

*For the Commission
On behalf of the President
[Position]*

4. Accompanying documents

4.1 Cost-benefit analysis / impact assessment

Introduction

1. This note outlines the assessment of the impact of the draft RTS regarding the specification of the derogations for currencies with constraints on the availability of liquid assets. The development of the draft RTS stems from the requirement presented in Article 419(5) of the CRR.

2. Article 10(1) of the EBA regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council) provides that when any draft regulatory technical standards developed by the EBA are submitted to the EU Commission for adoption, they shall be accompanied by an analysis of ‘the potential related costs and benefits’. This analysis should provide the reader with an overview of the findings regarding the problem to be dealt with, the solutions proposed and the potential impact of these options.

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 greatly undermined the financial health of many others, threatening financial stability and resulting in unprecedented levels of central bank liquidity and government support.

4. The CRR proposes two minimum standards for funding liquidity to address this issue. One of these requirements is the liquidity coverage requirement, which is intended to ensure that an institution has enough high quality liquid assets to survive an acute stress scenario lasting for 30 days. This requirement will help achieve the general objectives of CRD IV, as well as the following two specific objectives:

- ▶ enhancing adequacy of capital and liquidity requirements
- ▶ enhancing bank risk management

5. To meet the liquidity coverage requirement, institutions must hold a stock of high quality liquid assets (HQLA) to cover the total net cash outflows over a 30-day period. These assets should be liquid in markets during a time of stress and be eligible for use in central bank

refinancing operations. However, in some jurisdictions where there may be not enough HQLA available, the CRR allows institutions to use derogations to meet the liquidity coverage requirement. These derogations should be in line with what has been incorporated in the Basel III framework.

Issues addressed by the technical standard and objectives

6. The CRR mandates the EBA to develop draft regulatory technical standards specifying the derogations referred to in Article 419(2) of the CRR, including the conditions of their application. With these RTS, the EBA will clarify the conditions under which institutions can exercise these derogations and avoid the use of substantially divergent practices that could create an uneven playing field and uncertainty regarding the application of the liquidity coverage requirement across the European Union.

7. The RTS will help achieve the objectives of the directive of improving liquidity risk management and ensuring that the resilience of all institutions to short-term liquidity shocks is tested against the same benchmark across the single market.

Technical options considered

Notification

8. Institutions operating with a currency listed as constrained on the availability of liquid assets can decide themselves whether or not they will use the applicable derogations. The EBA proposes that they should also notify their national supervisory authority about their choice, to allow the authority to have a better view of the liquidity position of the institutions and to improve supervision of the liquidity risks.

Scope of application of the haircut under derogation A

9. In line with the approach advocated by the BCBS, an additional 8% haircut has to be applied to the foreign-currency-denominated assets held under this derogation, to control for the heightened level of currency risk. However, contrary to the BCBS, the EBA does not allow an exemption from this haircut. The BCBS, in this respect, allows competent authorities to set an exemption between 0% and 25% of these foreign assets. The EBA expects that most of the institutions operating in currencies for which the availability of liquid assets is limited will rarely need to hold more than 25% of foreign assets to meet their liquidity requirement. Therefore, allowing this exemption would have given an unduly advantage to institutions able to use this derogation as well as leading to an underestimation of the potential currency risk.

10. To appropriately reflect differences in exchange rate volatilities in currencies, the additional haircut can be lower than 8% in case of a mutually supported currency peg and higher in case of a non-global currency. In the first category (mutually supported currency peg), the entire currency band will be taken as a haircut, and in the second category (a non-actively traded

currency in global markets) the haircut is set to equal the largest monthly exchange rate movement between the relevant currencies in a 10-year period.

Haircuts and fee structure under derogation B

11. In line with the approach advocated by the BCBS, under derogation B the opportunity costs of actually holding a portfolio of qualifying liquid assets is simulated. For this reason, the EBA considers it appropriate that a central bank would set a haircut of at least 15%, which reflects the haircut applicable to assets referred to in Article 416(1)(d) of the CRR (assets with high liquidity and credit quality), in accordance with Article 418 of the CRR. For the same reason, the fees to be paid by institutions should offset the higher yield earned on the assets kept to secure the credit lines. Otherwise the institution involved would enjoy a direct economic benefit from applying the derogation.

Maximum level of derogation

12. The draft RTS also contain a limit to the total use of the derogations by institutions, which equals the relevant shortfall percentage in the annex of the draft ITS containing a list of currencies with constraints on liquid assets under Article 419(4) of the CRR. These percentages indicate the estimated aggregate shortfall compared with the aggregate demand generated by the liquidity coverage requirement for each currency on the list. In the view of the EBA, allowing each institution to cover its individual net outflows by means of the derogation up to the aforementioned percentage, the aggregate estimated shortfall in liquid assets can be offset. In this way, the use of derogations is inversely proportional to the availability of assets of high or extremely high liquidity and credit quality, such as is prescribed by Article 419(3) of the CRR. The setting of limits explained above aligns the draft RTS closer to principle 2 of paragraph 67 of the BCBS guidelines.

Impact

Costs

13. These RTS define only the conditions in which institutions can apply the derogation allowed in the CRR. The requirements made in these RTS are unlikely to raise material costs for the institutions that will use these derogations or for their national supervisory authorities.

14. The EBA has currently identified only a small number of currencies for which the availability of liquid assets is limited. 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

15. By specifying how the derogations to the liquidity coverage requirement can be applied, these RTS will ensure that the institutions exercising them have similar practices. The requirements proposed will ensure that they are inversely proportionate to the shortfall of liquid assets, and can be used when they are appropriate, without giving undue disadvantages to the institutions that are not allowed to use them. Finally, the requirement in term of notifications will also contribute to help national supervisory authorities to be informed of the liquidity management practices of the institutions they monitor without creating an excessive burden on institutions.

4.2 Views of the Banking Stakeholder Group (BSG)

The BSG has provided two comments on the proposed haircuts in the application of derogation A. Firstly, the BSG argues that institutions with activities in jurisdictions with deficits of available liquid assets, as defined by regulators, would face a double penalty since not only will the use of derogations be capped but also be subject to additional haircuts. Secondly, the BSG points out that the additional 8% haircut does not take into account the fact that currency risk may be hedged. The BSG also argues that 8% may be too high because in stress scenarios the currency in question has tended to depreciate in the past.

EBA response

These points are addressed in the table of Section 4.3.

4.3 Feedback on the public consultation and on the opinion of the BSG

The EBA publicly consulted on the draft proposal contained in this paper.

The consultation period lasted two months and ended on 22 December 2013. Nine responses were received, of which eight were published on the EBA website. The BSG also provided an opinion on the draft RTS.

This paper presents a summary of the key points and other comments arising from the consultation, the analysis and discussion triggered by these comments.

In many cases, several industry bodies made similar comments or the same body repeated its comments in the response to different questions. In such cases, the comments, and EBA analysis, are included in the section of this paper that the EBA considers the most appropriate.

No changes to the draft RTS have been made as a result of the responses received during the public consultation.

Summary of key issues and the EBA's response

General comments

Respondents generally welcomed the opportunity to comment on the EBA's proposal. Overall, there was a tendency for respondents to argue for fewer, or more lenient conditions of application and higher, or no limits on the overall use of the derogations. In contrast to this, other respondents were concerned about creating an uneven playing field as banks operating in countries with a liquid assets shortage might gain an advantage compared to banks operating in other jurisdictions.

Proposed notification mechanism

Many respondents argue that the 30-day notification mechanism would be difficult – or sometimes even impossible – for institutions to comply with because of the unpredictability of banking business.

EBA response

The EBA does not see how the notification requirements would be impossible to comply with. Especially since Article 2(2)(e) of the RTS only requires a best estimate of future use and not what the exact amount would be. Since the use of the derogation will have implications for a bank's risk positions, it is important for the competent authority to be notified at least 30 days in advance. Furthermore, as a part of adequate liquidity management, institutions can be expected to incorporate such estimates in their liquidity assessments.

Steps to prevent unnecessary use

Several respondents do not see all of the steps clearly described. One respondent would like the steps further specified in the regulation for example, to specify what banks should do when they ‘improve their management of the inflow cap’ or ‘change their liquidity management’. However no clear suggestions were provided.

Several respondents do not find the steps necessary as the use of derogations comes with a cost and therefore, they argue, banks would have a high incentive to reduce the need for derogations by reducing the need for liquid assets by sound liquidity management.

EBA response

The EBA acknowledges that in the fulfilment of these steps, it may be necessary for institutions to seek additional dialogue with the relevant competent authority. The fact that questions were raised about the direct application of some of these requirements reflects the principles-based nature of them, which is necessary to ensure that the conditions are suitable for business models with varying levels of risk and complexity. As there were no suggestions based on concrete rules in the feedback received, the EBA infers that this principles-based approach is indeed preferable.

As to the necessity of the steps, it remains the view of the EBA that some safeguard is necessary to ensure that the derogations are not used unnecessarily. The EBA acknowledges that the conditions for use of the derogations might be a disincentive to their use, but cannot be sure the conditions are such that no unwarranted use could happen.

Conditions of derogation

One respondent recommends removing the part of the requirement in Article 4(4)(a) of the RTS that asks for a ‘justification of’ since it is seen as something over and above the Basel requirements and, according to the respondent, would be a subjective criterion.

Some respondents argue that the use of derogation A would not be desirable as it would increase currency risk in the banking sector, especially for smaller banks, as they do not have foreign exposures as a significant or natural part of their businesses.

EBA response

In the view of the EBA the ‘and justified’ part of Article 4(4)(a) of the RTS remains necessary, especially because paragraph 59 of the BCBS standard reads as follows: ‘provided that the resulting currency mismatch positions are justifiable’.

Derogation A is provided by the CRR, and therefore the final draft RTS will have to include this derogation. In the view of the EBA, the application of derogation A, if all requirements of the final draft RTS are implemented, should not lead to undue currency risk in the banking system.

Criteria for evaluating historical evidence

Some respondents find that for currencies not actively traded in global foreign exchange markets the suggested 10-year period to measure exchange rate movements is very long. Five years are suggested as more appropriate.

One further suggests that it might also be appropriate to assess the risk in the relevant currencies based on average movements within the time period.

EBA response

No arguments are given why 10 years would be too long or too short. The BCBS standard also contains a 10-year period in this context.

The suggestion to look at average movements would not fit well into the liquidity coverage requirement context of gravely stressed conditions over a period of 30 days.

The additional 8% haircut under derogation A

Several respondents point out that the additional 8% haircut does not take into account the fact that currency risk may be hedged. One respondent suggest amending Article 4(5) of the RTS so that the 8% haircut only applies if the foreign exchange exposure is not fully hedged.

One respondent argues that the additional 8% haircut requirement does not recognise the risk-reducing correlation effects between liquidity stress in a domestic financial system and its foreign exchange rate. In periods of stress, some currencies may depreciate versus global reserve currencies, USD and EUR, so that banks holding foreign assets denominated in these currencies would benefit when converting these to their home currency.

EBA response

With regard to hedging, no hedging effects are taken into account for the haircuts of Article 418 of the CRR (valuation of liquid assets). Doing so in the context of the foreign exchange rate haircut of these RTS would therefore not be in line with the rest of the liquidity framework. In addition, it would be difficult to establish what kind of hedge would qualify, adding complexity to the framework. The EBA therefore has decided not to include hedging effects in these RTS.

The EBA would like to point out that even in the situation in which the foreign currency denominated assets involve many different currencies there is still the risk that the reporting currency appreciates strongly, leading to a lower relative value of all foreign currency denominated assets.

The EBA would further like to point out that where there is a currency peg, institutions may apply a haircut as low as the bandwidth of the exchange rate under certain conditions.

Workings and conditions of derogation B

Several respondents argue that the fee resulting from the conditions in relation to pricing should not be too high.

EBA response

The EBA would like to emphasise its aim to neutralise the benefits for the institution of such a credit line. This should not be unduly favourable/unfavourable to institutions in one currency area compared to another. If the conditions of these RTS were changed according to the conditions of facilities with other purposes that happen to exist with a certain central bank and not another, then the equal treatment of institutions between currency areas would not be maintained.

Limit the total use of the derogations

Some respondents argue that there would be no need to include the quantitative cap as they argue that use of derogations is already strictly framed with banks having to demonstrate that they have made all the possible efforts to reduce their need for these derogations together with the inclusion of specific haircut or pricing conditions.

Several respondents argue that the constraints should not be on a micro-level but rather be supervised by appropriate authorities with the possibility of taking additional steps towards the banks using derogations if the total usage of derogations exceeds the total estimated shortage of liquid assets.

One respondent further argues that capping the use of derogations based on a macro perspective may also have unintended consequences on the market for liquid assets. A macro level shortage of liquidity reflects a range of individual (micro) level shortages. Institutions with little or no shortage will have a cost incentive to retain their holdings of liquid assets, as they are capped and therefore scarce. This will further reduce the availability of liquid assets, i.e. increase the amount of locked-up liquid assets, thus increasing costs for institutions with a greater-than-average shortage.

EBA response

The EBA continues to be of the view that a high level of usage is prudentially undesirable and therefore continues to uphold the limit. The EBA does acknowledge that other disincentives are already in place which could help to keep the usage level down, although this is not certain. In addition, the EBA would like to link the usage limit to the shortage of liquid assets in that currency, which the conditions for usage themselves do not achieve. A limit wouldn't take effect if, as claimed, the conditions already kept the usage level low.

The EBA would like to emphasise the common rule book objective in the drafting of these RTS, which implies that no exemptions can be created that would depend on the decision of competent authorities. Furthermore, the CRR and the BCBS standard show the need for a usage limit that is linked to the shortage of liquid assets in that currency.

The applicable limit already takes into account the 110% liquidity coverage requirement target and a need to have a 25% free floating buffer, which implies that no shortage should occur if one or a few institutions aimed for a somewhat higher level. In addition, the market mechanism might allow some surplus liquid assets to be re-allocated to deficit banks, hopefully with the result that a very uneven allocation of liquid assets across the banking system would be rare. Not imposing a limit would disrupt the level playing field, especially for institutions operating in currencies that marginally did not qualify for the list of constrained currencies. Also in those countries, liquid assets could, theoretically, be concentrated in the hands of a few players.

Cost and benefit analysis

Several respondents argued that the requirements raised in these RTS will raise material costs for the institutions that use these derogations, including increased operational costs such as increased reporting requirements and efforts made to reduce the need for the derogations. In addition, reference was made to the haircuts on foreign currency denominated assets, increased foreign exchange risk, or, under derogation B, the fees paid for credit lines and that the need for derogations will be a disadvantage for these institutions. In contrast to this, another respondent argued that banks in Denmark and Norway will gain an advantage compared to banks operating in other jurisdictions like most of the CEE and SEE countries, where the demand for liquid assets is expected to exceed the supply of liquid assets in domestic currency.

EBA response

The combination of requirements is not designed, and also should not be designed, to bring a competitive advantage to the institutions using it, but rather to correct a pre-existing situation in which there is a shortage of liquid assets. Both derogations A and B (if provided by the relevant central bank) give institutions the opportunity to resolve this shortage. Costs, which are acknowledged by the EBA, tend to be relatively limited, given that the foreign currency haircut under option A is only 8%, and the fee structure under derogation B is mainly there to compensate for the yield difference between the asset pledged and assets of extremely high liquidity and the amount drawn.

The treatment in the final draft RTS are not considered to bring a competitive advantage to the institutions using them. Furthermore, as mentioned in the implementing technical standards adopted pursuant to Article 419(4) of the CRR, for the other currencies, the relevant competent authorities did not require analysis by the EBA on the potential qualification for the purpose of these final draft RTS. Therefore, the EBA does not have to assume that there is a pre-existing situation requiring correction.

Summary of responses to the consultation and the EBA’s analysis

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
General comments			
	<p>Some respondents have argued that the steps to safeguard against unnecessary use of the derogations would not be necessary, as the use of the derogation comes with a cost.</p> <p>Other respondents have argued that the steps wouldn’t be fully specified. For example, the step that requires institutions to ‘improve their management of the inflow cap’ or ‘change their liquidity management’.</p>	<p>It remains the view of the EBA that a safeguard is necessary to prevent the derogations being used unnecessarily. The EBA acknowledges that the conditions for use of the derogations might be a disincentive to their use, but has no reason to assume that disincentives on their own would prevent unwarranted use.</p> <p>The EBA acknowledges that in the fulfilment of these steps, it may be necessary for institutions to seek additional dialogue with the relevant competent authority. The fact that questions were raised about the direct application of some of these requirements reflects the principles-based nature of them, which is necessary to ensure that the conditions are suitable for business models with varying levels of risk and complexity. As there were no suggestions based on concrete rules in the feedback received, the EBA infers that this principles-based approach is indeed preferable.</p>	<p>No amendments made</p>
	<p>Some respondents argue that there would be no need to add the quantitative cap as they argue that use of derogations is already strictly framed with banks having to demonstrate that they have made all the possible efforts to reduce their need for these derogations and specific haircut or pricing conditions.</p>	<p>The EBA continues to be of the view that a high level of usage is prudentially undesirable and therefore continues to uphold the limit. The EBA does acknowledge that other disincentives are already in place which could help to keep the usage level down although this is not certain. In addition, the EBA would like to link the usage limit to the shortage of</p>	<p>No amendments made</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>One respondent further argues that capping the use of derogations based on a macro perspective may also have unintended consequences on the market for liquid assets. A macro level shortage of liquidity reflects a range of individual institution (micro) level shortages. Institutions with little or no shortage will have a cost incentive to retain their holdings of liquid assets, as they are capped and therefore scarce. This will further reduce the availability of liquid assets, i.e. increase the amount of locked-up liquid assets, thus increasing costs for institutions with a greater-than-average shortage.</p>	<p>liquid assets in that currency, which the conditions to usage themselves do not achieve. A limit wouldn't take effect if, as claimed, the conditions already kept the usage level low.</p> <p>The applicable limit already takes into account the 110% liquidity coverage requirement target and a need to have a 25% free floating buffer, which should mean that no shortage would occur if one or a few institution would aim for a somewhat higher level. In addition, the market mechanism might allow some surplus liquid assets to be re-allocated to deficit banks, possibly with the result that a very uneven allocation of liquid assets across the banking system should be rare. Not imposing a limit would disrupt the level playing field, especially for institutions operating in currencies that marginally did not qualify for the list of constrained currencies. In those currencies, liquid assets could, theoretically, be concentrated in the hands of a few players.</p>	
<p>Responses to questions in Consultation Paper EBA/CP/2013/39</p>			
<p>Proportionality</p>	<p>Two respondents argue that the principle of proportionality (PoP) has been insufficiently taken into account in the drafting of these rules. They point out that derogation A will lead to currency risk, which would be undesirable for smaller banks that did not have foreign exposures as a natural part of their businesses.</p>	<p>The EBA values the principle of proportionality highly but at the same time has had to develop the final draft RTS so that risks originating from use of the derogations are properly mitigated. To balance these objectives, the EBA has opted for the requirement as set out in Article 4(4)(a) of the RTS, which does address the need to mitigate these risks, but on the other hand, by being principles-based, does not force disproportionately burdensome management of foreign exchange risk upon smaller institutions.</p>	<p>No amendments made</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
<p>Question 1.</p> <p>Do you agree with the proposed notification mechanism its contents and timelines? If not, why not, and what should be altered?</p>	<p>Most respondents agree that it will be appropriate to have a notification mechanism.</p> <p>However, many respondents argue that the 30-day notification mechanism would be difficult – or sometimes even impossible – for institutions to comply with because of the unpredictability of the banking business. Several respondents argue further that changes in market conditions could cause institutions to be unable to comply with the 30-day notification mechanism. One respondent therefore suggests that the wording ‘In exceptional circumstances’ in Article 2(1) of the RTS should be changed to allow for a broader interpretation.</p> <p>One respondent suggests that notification of substantial use should be done when it is possible, not 30 days in advance and that if the use of this notification is meaningless at this time it should be dropped from the regulation.</p> <p>Some respondents argue that the updating of notification should not be annually, but be at a shorter interval.</p>	<p>The EBA does not see how the notification requirements would be impossible to comply with. Especially since Article 2(2)(e) of the RTS only requires a best estimate of future use and not what the exact amount would be. In addition, since the use of the derogation will have implications for a bank’s risk positions, it is important for the competent authority to be notified at least 30 days in advance. Furthermore, as part of adequate liquidity management, institutions can be expected to incorporate such estimates in their liquidity assessments.</p> <p>The EBA does not see why an annual update is considered infrequent. Any material change in the use of the derogation has to be notified 30 days in advance.</p>	<p>No amendments made</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
<p>Question 2.</p> <p>Are the steps to prevent the unnecessary use of a derogation clearly described? Do you see these steps as appropriate? If not, why not, and what should be altered? Are there any additional specifications that could clarify the assessments under paragraphs 1 and 2 of Article 3 of the RTS?</p>	<p>Several respondents do not think all the steps are clearly described. One respondent would like, for example, additional specifications of what banks should do when they ‘improve their management of the inflow cap’ or ‘change their liquidity management’.</p> <p>One respondent raises the question regarding the period during which an institution must demonstrate that it has used sound liquidity management to reduce its need for liquid assets. The respondent does not find it necessary to prescribe a particular period in the RTS and instead suggests that this issue can be covered as part of the annual supervisory liquidity review process.</p> <p>Several respondents do not find the steps necessary as the use of derogations comes with a cost and therefore, they argue, banks would have a large incentive to reduce the need for derogations by reducing the need for liquid assets by sound liquidity management.</p> <p>One respondent argues that requiring banks to test the price effect of purchases of liquid assets in markets where there is a shortage of available assets would result in unnecessary volatility, and for larger banks it might also be in conflict with market abuse regulations due to the size of the required purchases.</p>	<p>The EBA acknowledges that in the fulfilment of these steps, it may be necessary for institutions to seek additional dialogue with the relevant competent authority. The fact that questions were raised about the direct application of some of these requirements reflects the principles-based nature of them, which is necessary to ensure that the conditions are suitable for business models with varying levels of risk and complexity. As there were no suggestions based on concrete rules in the feedback received, the EBA deduces that this principles-based approach is indeed preferable.</p> <p>As to the necessity of the steps, it remains the view of the EBA that some safeguard is necessary to ensure that the derogations are not used unnecessarily. The EBA acknowledges that the conditions for use of the derogations might be a disincentive to their use, but cannot be sure the conditions are such that no unwarranted use could happen.</p> <p>Testing the price sensitivity of a market is only mentioned as an example of complying with Article 3(2) of the RTS.</p>	<p>No amendments made</p>
<p>Question 3.</p>	<p>One respondent recommends the part of the requirement in Article 4(4)(a) of the RTS is</p>	<p>In the view of the EBA the ‘and justified’ part of Article 4(4)(a) remains necessary, especially also</p>	<p>No amendments</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
<p>Are the workings and conditions of derogation A clearly described? Do you see these steps as appropriate? If not, why not, and what should be altered?</p>	<p>removed that asks for a ‘justification of’ on the basis that it is deemed additional to the Basel requirements and, according to the respondent, would be a subjective criterion.</p> <p>One respondent asks the EBA to clarify how to handle intra-group transactions which involves different currencies.</p> <p>Some respondents argue that the use of derogation A would not be desirable as it will increase currency risk in the banking sector, especially for smaller banks, as they do not have foreign exposures as a significant or natural part of their businesses.</p> <p>One respondent strongly recommends the introduction of the third derogation in the BCBS to allow additional use of assets of high liquidity and credit quality (e.g. certain covered bonds) in the liquidity buffer. This of course depends on the final definition of HQLA and whether the Commission will introduce a cap on the amount of assets of high liquidity and credit quality in the liquidity buffer. This third derogation would, according to the respondent, allow banks to hold a more diversified liquidity buffer than mainly government bonds and central bank reserves and furthermore the use of this derogation could assist in breaking</p>	<p>since in this context paragraph 59 of the BCBS standard reads as follows: ‘provided that the resulting currency mismatch positions are justifiable’.</p> <p>The normal CRR stipulations regarding the scope of consolidation rules and significant currency apply.</p> <p>Derogation A is provided for by the CRR, and therefore the final draft RTS will have to include this derogation. Furthermore, in the view of the EBA, the application of derogation A, if all requirements of the final draft RTS are implemented, would be very unlikely to lead to undue currency risk in the banking system.</p> <p>The EBA cannot pre-empt the Commission’s delegated act on liquidity coverage requirements under Article 460 of the CRR with these final draft RTS. Note that in its report to the Commission on introducing liquidity coverage requirements in the EU under Article 509(1) of the CRR, the EBA was to assess, under point (h) of paragraph 2 of that Article, the derogations from requirements on the composition of the liquid assets that institutions would be required to hold, where in a given currency the institutions’ collective justified needs for liquid assets exceeded the availability of those liquid assets, and conditions to which such derogations should be subject.</p>	<p>made</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	the link between governments and banks.		
<p>Question 4.</p> <p>What criteria would you regard as useful for evaluating the historical evidence as mentioned in paragraph (4a) of Article 4?</p>	<p>Some respondents find that for currencies not actively traded in global foreign exchange markets the suggested 10-year period to measure exchange rate movements is very long. Five years are suggested as more appropriate.</p> <p>One suggests further that it might also be appropriate to assess the risk in the relevant currencies based on average movements within the time period.</p>	<p>No arguments are given why 10 years would be too long or too short. The BCBS standard also contains a 10-year period in this context.</p> <p>The suggestion to look at average movements would not fit well into the liquidity coverage requirement context of gravely stressed conditions over a period of 30 days.</p>	<p>No amendments made</p>
<p>Question 5.</p> <p>Is the additional 8% haircut on foreign-currency-denominated assets held under derogation A appropriate? If not, why not, and what alternative treatment would you propose?</p>	<p>Several respondents point out that the additional 8% haircut does not take into account the fact that currency risk may be hedged. One respondent suggest amending Article 4(5) of the RTS so that the 8% haircut only applies if the foreign exchange exposure is not fully hedged.</p> <p>Some respondents find it unclear how the 8% haircut has been obtained and ask if empirical investigations of exchanges in a stressed environment have been made.</p> <p>One respondent argues that competent authorities should be able to allow for exemptions from the additional 8 % haircut as in the BCBS standard, which in paragraph 61 refers to a need to accommodate a certain level of currency mismatch that may commonly exist among banks in their</p>	<p>With regard to hedging the EBA would like to point out that also for the haircuts of Article 418 of the CRR, valuation of liquid assets, no hedging effects are taken into account. Doing so in the context of a foreign exchange rate haircut in these RTS would therefore not be in line with the rest of the liquidity framework. It would also be difficult to establish what kind of hedge would qualify, adding complexity to the framework. The EBA therefore has decided not to include hedging effects in these RTS.</p> <p>Regarding the level of the 8% haircut, to be consistent with BCBS, the BCBS standard also applies this haircut level.</p> <p>The EBA would like to emphasise the common rule book objective in the drafting of these RTS, which implies that no exemptions can be created that would depend on the decision of competent authorities. Furthermore, the EBA is of the view that also a minor level of currency mismatch already</p>	<p>No amendments made</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>ordinary course of business.</p> <p>One respondent argue that the additional 8% haircut requirement does not recognise the risk-reducing correlation effects between liquidity stress in a domestic financial system and its foreign exchange rate. In periods of stress, some currencies may depreciate versus global reserve currencies, USD and EUR, so that banks holding foreign assets denominated in these currencies would benefit when converting these to their home currency.</p>	<p>leads to exchange rate risk.</p> <p>Even in the situation in which the foreign currency denominated assets involve many different currencies, the risk continues to exist that the reporting currency appreciates strongly, leading to a lower relative value of all foreign currency denominated assets.</p> <p>With a currency peg, institutions may, under certain conditions, apply a haircut as low as the bandwidth of the intervention range.</p>	
<p>Question 6.</p> <p>Are the workings and conditions of derogation B clearly described? Do you see these steps as appropriate? If not, why not, and what should be altered?</p>	<p>Some respondents are concerned that EBA would be going beyond its mandate when specifying the price conditions of central bank facilities to banks, as well as the haircuts to be applied by the central bank to the collateral. These credit facilities, according to the respondent, would be part of the tools available for the central bank to lead the monetary policy, and therefore the respondent emphasises that the pricing conditions should remain its prerogative.</p> <p>Several respondents argue that the fee resulting from the conditions in relation to pricing, should not be too high, as otherwise the banks would possibly not resort to these facilities and would rather acquire term funding from the central bank.</p>	<p>The EBA would like to emphasise that Article 4(b) of the RTS does not pre-empt the decision of central banks on their monetary policy instruments, but only gives the conditions under which a central bank facility would be recognised as an alternative to liquid assets according to these RTS. Central banks will not be constrained from creating other credit facilities that do not meet these conditions for other purposes. Regarding any potential interaction with monetary policy, the credit facility referred to in this Article is only required to facilitate the use of the derogation up to the limit indicated in Article 6 of the RTS.</p> <p>The EBA would like to emphasise that its aim is to neutralise the benefits for the institution of such a credit line. This should not be unduly favourable/unfavourable to institutions in one currency area compared to another. If the conditions</p>	<p>No amendments made</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>One respondent further point out that there is a stigma associated with the use of central bank lending facilities if not part of ordinary money market operations.</p> <p>One respondent says that both derogation A and B would pose difficulties for the conduct of monetary policy in Denmark and the currency peg towards the euro, but does not explain why. Another respondent suggests that under derogation B, imposing higher rates on a (specific type of) credit facility could distort monetary policy and in this context mentions possible unpredictability of institutions' use of the credit facility.</p>	<p>of these RTS were changed according to the conditions of facilities with other purposes that happen to exist with a certain central bank and not another, then the level playing field between currency areas would not be maintained. The EBA would like to emphasise that in currencies with no shortage of liquid assets, there would also be a similar trade-off between acquiring term funding at the central bank (or money market) and holding of other types of liquid assets.</p> <p>The EBA has no reason to expect a stigma from the use of a central bank facility when this is for the purpose of these final draft RTS. These facilities are not a form of emergency liquidity assistance.</p> <p>The EBA has no reason to expect any particular detrimental impact on monetary policy since the credit facility referred to in this Article is only needed to facilitate the use of the derogation up to the limit indicated in Article 6 of the RTS.</p>	
<p>Question 7.</p> <p>Is the proposal to limit the total use of the derogations by an institution to the relevant shortage percentage in the annex of the draft ITS containing a list of currencies</p>	<p>Some respondents argue that there would no need to include the quantitative cap as they argue that use of derogations is already strictly framed with banks having to demonstrate that they have made all the possible efforts to reduce their need for these derogations and specific haircut or pricing conditions.</p>	<p>The EBA continues to be of the view that a high level of usage is prudentially undesirable and therefore continues to uphold the limit. The EBA does acknowledge that other disincentives are already in place which could help to keep the usage level down, although this is not certain. The EBA would like to link the usage limit to the shortage of liquid</p>	<p>No amendments made</p>

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<p>with constraints on the availability of liquid assets under Article 419(4) of the CRR clearly described? If not, why not, and what further matters should be included? Do you see these stipulations as appropriate? If not, why not, and what should be altered?</p>	<p>One respondent cannot understand what ‘the relevant percentage’ threshold should be as mentioned in Article 6(1) of the RTS.</p> <p>Some respondents note – as also stated in responses to the EBA CP on the draft ITS regarding currencies with constrained availability of liquid assets (EBA/CP/2013/38) – that the method suggested for calculating the shortage of liquid assets is not sufficiently robust and transparent.</p> <p>Several respondents argue that the constraints should not be on a micro-level but rather be supervised by appropriate authorities with the possibility of taking additional steps towards the banks using derogations if the total usage of derogations exceeds the total estimated shortage of liquid assets.</p> <p>One respondent further argues that capping the use of derogations based on a macro perspective may also have unintended consequences on the market for liquid assets. A macro level shortage of liquidity reflects a range of individual institution (micro) level shortages. Institutions with little or no shortage will have a cost incentive to retain their</p>	<p>assets in that currency, which the conditions to usage themselves do not achieve. A limit wouldn’t take effect if, as claimed, the conditions already kept the usage level low.</p> <p>The relevant percentage is the percentage that is specified for that currency in the implementing technical standards adopted pursuant to Article 419(4) of the CRR, which will be subject to reviews when deemed necessary.</p> <p>See answers to the related feedback table for the implementing technical standards adopted pursuant to Article 419(4) of the CRR.</p> <p>There is a common rule book objective in the drafting of these RTS, which implies that no exemptions can be created that would depend on the decision of competent authorities. Furthermore, the CRR and the BCBS standard point to the need for a usage limit that is linked to the shortage of liquid assets in that currency.</p> <p>By taking the shortage numbers from the implementing technical standards adopted pursuant to Article 419(4) of the CRR, the applicable limit already takes into account the 110% liquidity coverage requirement target and a need to have a 25% free floating buffer, which implies that no shortage should occur if one or a few institution would aim for a somewhat higher level. In addition, the market mechanism might allow some surplus</p>	

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	<p>holdings of liquid assets, as they are capped and therefore scarce. This will further reduce the availability of liquid assets, i.e. increase the amount of locked-up liquid assets, thus increasing costs for institutions with a greater-than-average shortage.</p>	<p>liquid assets to be re-allocated to deficit banks, possibly with the result that a very uneven allocation of liquid assets across the banking system would be rare. Not imposing a limit would disrupt the level playing field, especially for institutions operating in currencies that marginally did not qualify for the list of constrained currencies. In those countries, liquid assets could, theoretically, be concentrated in the hands of a few players.</p>	
<p>Question 8.</p> <p>Do you agree with the above analysis of the cost and benefit impact of the proposals?</p>	<p>Several respondents do not agree with point 14 in the cost-benefit analysis as the requirements in these RTS will raise material costs for the institutions that use these derogations, including higher operational costs such as increased reporting requirements and efforts made to reduce the need for the derogations.</p> <p>Some respondents emphasise that the derogation is a necessary compensatory measure without which compliance with the liquidity coverage requirement would be impossible in some cases. One argues that the efforts made to reduce the need for the derogation, the haircuts on foreign currency denominated assets, increased foreign exchange risk, or, under derogation B, the fees paid for credit lines will pose a disadvantage for these institutions.</p>	<p>The EBA does not see how the notification requirements and reporting requirements associated with these RTS, which are very limited, would lead to any material costs.</p> <p>The combination of requirements is not designed, and also should not be designed, to bring a competitive advantage to the institutions using it, but rather to correct a pre-existing situation in which there is a shortage of liquid assets. Both derogations A and B (if facilitated by the relevant central bank) give institutions the opportunity to resolve this shortage. Costs, which the EBA acknowledge are there, tend to be relatively limited given that the foreign currency haircut under option A is only 8%, and the fee structure under derogation B is mainly there to compensate for the yield difference between the asset pledged and assets of extremely high liquidity and the amount drawn. Furthermore, when institutions deem the costs associated with the derogation to be excessive,</p>	<p>No amendments made</p>

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		they might resort to deposits with the central bank or cash available to comply with the liquidity coverage requirement.	
<p>Question 9.</p> <p>Please provide any evidence or data that would further inform the analysis of the likely cost and benefit impacts of the proposals.</p>	<p>No specific comments.</p> <p>One respondent made two references:</p> <p>http://www.bis.org/publ/rpfx13fx.pdf</p> <p>http://www.norges-bank.no/pages/97937/BIS_Report_2013_eng.pdf</p>	<p>These studies cover turnover in the foreign exchange markets. No direct use suggested for the studies, and the EBA does not find any information therein that would influence its assessment.</p>	<p>No amendments made</p>

