

Consultation on EBA-CP-2012-18 - Additional Liquidity Monitoring Metrics under Article 403(2) of the draft Capital Requirements Regulation (CRR).

**Replies to selected questions
and comments by the EBA Banking Stakeholder Group**

**Question 1:
Are the proposed remittance dates feasible?**

It is our understanding that the remittance dates for Additional Liquidity Metrics will be synchronized with those for the LCR and other liquidity-oriented measures introduced by the CRR. While we encourage such a choice, we recommend that remittance dates for all liquidity-related data be set in a way that gives banks enough time to extract, validate and file data that is of adequate quality and fully reliable.

A 15-day delay after the reporting reference date may prove hard to comply with (and possibly detrimental to data quality), especially upon the initial implementation of the new reporting schemes. We therefore advocate that the delay be initially set to a longer time window (e.g. 60 days) and then reduced gradually to 15 (ideally 30) days when the banks' reporting processes have been fully implemented and validated, and the quality of the submitted data is considered satisfactory.

A longer remittance period should also be allowed when the reference date for additional liquidity monitoring metrics coincides with a bank's annual (and quarterly) financial report. This would enable banks to ensure that the detailed data on liquidity items provided to supervisors can be reconciled with aggregate data reported to investors and third parties in the balance sheet.

**Question 2:
Are the proposed frequency dates feasible? has the proportionality been adequately considered?**

One of the templates mentioned in the Consultation Paper, (that relating to funding concentration product type) is unlikely to change briskly in a few weeks. Accordingly, the EBA might consider a quarterly frequency for the provision of that data template (irrespective of whether the bank's total assets fall below 1% of all supervised institutions), unless mandated otherwise by the CRR. More generally, under normal business conditions, liquidity-related figures are unlikely to change so quickly that monthly reporting is required. Quarterly reporting may prove adequate, provided that supervisors are entitled (as they are) to increase frequency to monthly if other indicators signal a distressed liquidity environment.

Question 3:

Is the above size threshold of 1% of total assets suitable to determine a higher reporting frequency? Should such threshold be substituted or complemented by a liquidity-risk-based threshold or other quantitative criteria? If so, by which?

Criteria to identify institutions allowed to submit their reports on a quarterly basis could refer to both the institution's size *and its liquidity risk*. For example, institutions where the ratio of the individual balance sheet total to the sum of individual balance sheet totals of all institutions under the supervision of the competent authority is below 5% and the LCR exceeds some minimum level (denoting a highly liquid institution) may also be made eligible for quarterly reporting.

Question 4:

Are the reporting templates and instructions sufficiently clear? Shall some parts be clarified? Shall some rows/columns be added or deleted?

The inclusion in the ITS of additional data templates that were not explicitly indicated by the Basel Committee in January 2013, should be evaluated with care, in order to avoid further increasing the rapidly growing burden on banks of reporting liquidity positions. This applies, for example, to the template for data collection on funding sources, which may prove hard to collect and may convey misleading information (because of the different conditions associated to instruments which fall under the same label). Reporting by significant currency will multiply the number of reports submitted by institutions and where possible regulators should consider using existing reports, such as the data on LCR components, to monitor currency exposures.

Additionally, it should be borne in mind that details on funding rates may prove difficult and costly to gather and could easily be misinterpreted. As an alternative to including them in the data flow on additional liquidity monitoring metrics, the EBA might usefully consider incorporating them in the European ILAAP SREP that is currently under development.

Regarding the concentration of funding by counterparty, it could be argued that large investors could be scared away by the risk of seeing their names in the list of the ten top names exceeding 1%. EBA could consider setting up (and advertising) an appropriate set of measures to ensure that confidentiality issues are carefully dealt with. Alternatively, EBA may content itself with a list that does not include actual names, but assesses funding concentration based on other fields in the data model (e.g. LEI code, industry, residence etc).

We appreciate the fact that, for many items, the maturity ladder template includes a separate detail for intra-group flows (including flows between the members of an institutional protection scheme). EBA may wish to consider whether other templates, should also report separate details for intra-group (and intra-network) transactions, since the latter generally have different risk characteristics than transactions conducted at arm's length. Failing this, EBA should consider giving greater clarity with regard to how intra-group flows are to be reported at the group level.

Regarding „behavioural flows” (Annex I) the EBA may wish to clarify better how institutions should define the „base case economic scenario used in current business planning”, in order to avoid the risk of an unlevel playing field in supervisory practices, that makes cross-bank (and cross-country) comparisons of limited use.

Finally, the EBA may wish to clarify whether the terms „Counterbalancing Capacity” and „high and extremely high quality liquid assets” have different implications or can be considered as synonyms.

Question 5:

Could you indicate whether all the main drivers of costs and benefits have been identified in the table above? Are there any other costs or benefits missing? If yes, could you specify which ones?

As a general comment, we wish to stress that implementation costs will be very different depending on the size of the institutions, groups or networks that will be required to submit the new additional liquidity metrics. Additionally, it should be emphasized that, since implementation costs are typically one-off items, one way of optimising the cost/benefit ratio of the new data templates is to ensure that they remain stable over time and are not subject to frequent changes regarding their contents and structure.

Question 7:

Do you agree with our analysis of the impact of the proposals in this CP? If not, can you provide any evidence or data that would explain why you disagree or might further inform our analysis of the likely impacts of the proposals?

The EBA has produced a cost-benefit analysis where compliance costs are mostly expected to be limited or low. We suggest that EBA does not limit its analysis to “one-off” expenses, but also includes “ongoing” compliance costs in its estimates, bearing in mind that considerable resources will have to be spent on creating and updating tables, definitions, instructions, etc. Also, new personnel will have to be recruited to cross-check and validate the new data flows.

Consultation on EBA-CP-2012-19 - Additional Liquidity Outflows corresponding to Collateral Needs [...] under Article 411(3) of the Draft Capital Requirements Regulation (CRR).

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Question 2:

Does the specification in paragraph 2 give sufficient clarity on which flows are included and excluded for the purposes of this RTS? If not, please provide an alternative specification.

For the avoidance of doubt, the definition of “margining set” could be further clarified. In particular, EBA may wish to clarify that the new rules apply to trades falling outside margining set only to the extent that those trades are subject to a margining agreement (in other words, trades that can be seen as a margining set including just one item), while trades not subject to margins can be ignored.

Question 5:

Are there any aspects of the standard method that you would describe differently? If so, how would you describe these? Are there methodological concerns? If so, what are these and how should they be addressed? Are the scenarios described in annex I appropriately calibrated? If not, how would you suggest improving calibration?

The Standard approach could be made easier to implement by calculating the impacts of each stress scenario per risk factor based on sensitivity analysis (as in delta/normal VaR models) instead of requesting a full re-valuation of outstanding positions. While this may lead to results that are only approximate, it appears to be fully legitimate, since risk estimates based on first order derivatives are customarily accepted for Value at Risk calculations for market or counterparty risks.

Additionally, the Standard approach involves a number of steps and the whole process might prove too complex to implement (the example provided in the Consultative Paper entails more than 10 steps to estimate the size of the collateral outflow...). It would therefore be useful to explore ways of simplifying some steps (e.g. by ignoring inflows outside a margining set or by skipping point c, as the outcome would not differ significantly from the results shown under points a and b).

Question 11:

Are there any aspects of the simplified method that you would describe differently? If so, what are these and how would you describe them? Are there methodological concerns? If so, please provide details of these concerns and how in your view they

could be addressed? Are the outflows factors described in annex II appropriately calibrated? If not, please describe how they should they be calibrated, justifying your proposal?

The simplified approach is based on outflow rates applied to notional amounts. We understand that notional values provide a reference base that could prove more reliable than the contracts' fair values (a trade could have a mark to market value close to zero and yet still involve the risk of considerable collateral outflows). Nevertheless, we suggest that – given the simplified nature of this method – the EBA explores the feasibility of using the contracts' mark-to-market as an alternative basis for computation. Fair values are extensively used by quite many institutions for accounting and prudential purposes (e.g., derivatives are recorded at fair value under the IFRS, while the “current exposure method” for counterparty risk is based on mark-to-market plus an add-on). It may prove easier for institutions to retrieve that type of information.

The simplified approach is applied on the whole derivatives portfolio, with no special treatment for trades included in a margining set. This leads to very conservative figures, which may overstate the actual risk of a bank. Furthermore, there may be trades that are included in a bank's derivatives portfolio but are not subject to any margining agreement (in which case it would be unfair to include them in the basis for computation).

It is unclear whether outflow rates have been calibrated on the basis of an estimate of the expected variability in collateral flows (possibly in a period of stress) or rather have been set very conservatively in order to provide a strong incentive for institutions to apply the standard method. While it may be appropriate for regulation to provide incentives for banks to migrate to more sophisticated approaches, it should be borne in mind that over-conservative weights would in the end prove detrimental for the credibility of the new rules.

Furthermore, the simplified method may only prove applicable to a very limited number of institutions, since the eligibility thresholds are very low, and crossing them would trigger a very punitive treatment.

In light of the above (conservative coefficients, limited scope for eligibility) banks will not be encouraged to apply for the simplified approach. One may therefore wonder whether such a method is really necessary, or rather could be abandoned and converted into a “simplified” version of the standard method. Alternatively, the eligibility thresholds for the simplified methods could be eased, so that a larger number of banks is incentivised to use it.

Question 15:

Are there any aspects of the advanced method based on EPE that you would describe differently? If, so please provide details? Are there methodological concerns? If so, please provide details of these concerns and how in your view they could be addressed? Are there any additional adjustments or conditions that you see as appropriate especially in view of an absence of an approval process? If so, please provide details? Is the 99% confidence level appropriate? If not, please justify why?

The fact that the advanced approach is limited to institutions having a validated advanced (EPE) model for counterparty risk is correct in principle. In fact, EPE models allow banks to estimate the future variability in the fair value of OTC transactions, also for specific provisions in margining contracts (such as minimum transfer amounts, thresholds to post margin or asymmetry clauses).

However, from a practical point of view, the transposition of EPE models to calculate additional collateral outflows may prove expensive and complex for institutions, due to the following reasons:

- counterparty risk is calculated over a one-year horizon, whereas the time horizon for collateral outflows is one month (as for the LCR). The shift to a different time window may require significant changes in the Monte Carlo engines used for EPE calculations;
- EPE models often are not used/validated for the entire range of derivatives and counterparties. To extend their use to all derivatives / counterparties may prove difficult to implement, and lead to different scopes of application of the same model for counterparty risk and liquidity risk purposes.

Based on the latter remark, the EBA might consider recommending the use of the advanced method on the same perimeter for which EPE models have been validated, and ask banks to treat other derivatives/counterparties under the standard approach (unlike in the present draft of the ITS, where institutions are not allowed to combine different methods). It is unclear, however, whether banks would be willing to use two different methods to estimate additional collateral outflows (facing higher development and production costs).

Question 21:

How would you like to see the historical look-back approach calibrated? Please provide details together with a justification.

The “historical look back” approach as proposed by the Basel Committee on Banking Supervision in January 2013 (cf. § 123 – Basel III - The Liquidity Coverage Ratio and liquidity risk monitoring tools) could provide a conceptually simple framework that could be applied across the board to all institutions. This method based on the maximum amount of collateral outflows observed during the preceding 24 months period has the following advantages:

- the way additional outflows are calibrated is readable and easily explainable (stress tests based on historical observations);
- outflows are determined on a global basis: stress tests and re-valuation need not be applied separately by risk factor and then compounded together, as is the case in the standard or simplified approach;
- it can easily be implemented by institutions without leading to excessive costs. Indeed, historical collateral claims are usually available to the Back Office or through collateral management systems.