1. General Comments:

We welcome the opportunity to have an ongoing dialogue with European Banking Authority (EBA) for the elaboration of Binding Technical Standards (BTS), Implementation Technical Standards (ITS), Guidelines and the Frequently Asked Question (FAQ) process.

We acknowledge that the present consultation is a preparatory work for the consultation that EBA shall launch on the basis of the legal texts, when in force. It would be desirable to ensure consistency on the timeline for the EBA RTS and ITS and for the observation period. Inconsistency could jeopardize the work to be carried out in this regard.

The Discussion Paper (DP) on defining liquid assets intends to develop a quantitative methodology to derive asset class described with simple characteristics: we support EBA objective to target definition of Liquid Assets based on asset class and easy to get (publicly available) asset’s characteristics, provided that the number of asset classes and subcategories are not too numerous and are flexible enough to accommodate evolution in assets or market environment.

As the classification process will need to be updated over time for changes in market environment, it is important that the classification process is made transparent enough to enable banks to duplicate it so that they can anticipate changes in regulator-defined asset classes and avoid ‘cliff effects’ that would happen at each regulatory update. This would also be helpful in dealing with assets that are not covered by EBA methodology (ie: non EU assets). The possibility to duplicate the classification process will require that it is based on publicly and easily available data (rather than on data available only to regulators, such as MiFID data).

The DP deals exclusively with market-liquidity and does not consider the roles of Central Banks in enhancing market-liquidity and in providing funding. As LCR is based on a systemic liquidity crisis assumption, and considering the evidence that during the 2008 liquidity crisis market-liquidity disappeared for numerous assets that were deemed market-liquid before the crisis, it is important to recognize that a prudential liquidity regulation shouldn’t be built on the assumption that market-liquidity will be resilient in a liquidity crisis. Consequently, the role of Central Banks in mitigating systemic liquidity crisis should be recognized and considered.

In other words, to be consistent with evidence, and to mitigate systemic risk, assets that are operationally eligible to central bank facilities should be considered as a sufficient criterion to be considered as a Liquid Assets.
The envisaged methodology bases its analysis on academic papers on asset market-liquidity. However, the conclusions that could be derived from the listed academic papers are:

- even though the subject has been analyzed for almost 30 years (Roll(1984)), there is no consensus in the academic community on how to deal with asset market-liquidity,
- ... except that each market has its own characteristics and each set of available data leads to adopt a market-specific approach,
- most of the academic papers are focus on liquidity pricing, based on buy/sale transactions only and completely ignores the fundamental role of the repo market in providing ‘funding’-liquidity and mainly focus on non-European markets

That is the reason why the comprehensive, single-methodology approach that EBA envisages seems very, if not too, demanding, while ignoring the fundamental repo market. We suggest that EBA complements its methodology with market-specific, publicly available data-adapted methodology. As publicly available data may differ between asset classes, this will enable to have a flexible methodology.

Definitively, the definition of asset liquidity is an extremely difficult issue to address with a comprehensive single-methodology-based approach. Flexibility is a key factor for successfully meeting this challenge.

By the way, flexibility is needed to have an approach that can (and actually should) be updated regularly (cf. infra).

As is, the suggested methodology has several shortcomings that need to be addressed:

- As is, the methodology is based only on buy and sale historical data, which denies the role of repurchase agreements (repo) market in the liquidity of assets through both its funding capacity (repo side) and sale-enhancing capacity (reverse repo side that enables to sell asset obtained through reverse repo). The traded volumes on repo markets (bilateral repo, tri-party repo and CCP repos) are huge and are often bigger than the volumes on buy and sale market. Considering the repo market is absolutely necessary for any Liquid Asset classification process: as such, it is an explicit criterion in the BCBS latest guidelines.

- As only European assets will be considered by EBA:
  - the classification process of non-European assets should be clarified. If the classification is left to the institution, why not European assets too?
  - EBA classification will apply to institutions only to the extent they, or the Group they are part of, are subject to CRR-LCR requirement. This will level the playing field within Europe, which we fully support. However, European institutions and European Groups will be at competitive disadvantage compared to institutions or Groups that would not be subject to CRR-LCR and that operate on the very same assets.

- The requirement to extend the classification process to equities will lead to adopt an equity-specific classification process, which is necessary and pragmatic as the market and available data are equity-specific. We suggest that EBA classification process does not need to be a one-size-fits-all. As an illustration, assets that are eligible to General Collateral Basket for repo in major CCPs should be considered liquid without further requirement as trillion euros of repos are executed on these assets.

- As market-liquidity and asset classes evolve over time, EBA should clarify what will be the update process over time to adapt the definition of Liquid Assets to an evolving environment.

- Any single and official process that would identify liquid assets will magnify the market-liquidity of assets deemed liquid, and be detrimental to market liquidity deemed not liquid
enough. The pro-cyclicality of the definition of Liquid Assets should be carefully analyzed, so as to minimize the regulatory-driven increase in systemic risk.

- **The suggestion that haircuts of Liquid Assets should be derived from their price volatilities basically denies that those assets will benefit from a flight-to-quality, which should lead to a gross-up factor rather than a haircut. It would also deny the diversification effect between the different assets in the liquidity buffer.**

Besides, as mentioned in Article 481, European authorities should consider the ‘international regulatory development’ in modifying the LCR parameters (such as the definition of Liquid assets and the applicable haircuts). We are unaware of any other jurisdictions that are in the process of adopting higher outflow rates for retail deposits. **We urge European authorities to avoid gold plating LCR and not to introduce higher than BCBS-proposed haircuts.**

- **As EBA intends to base its methodology on a MiFID database that is not accessible to banks, it is essential that EBA discloses its process in sufficient details to facilitate an open discussion that help identifying potential biases in the database or in the analyses. As an illustration of potential biases, the ‘database cleaning process’ is important to explain as it can have major consequences on the obtained classification (to what extent is the database cleaned? what are the characteristics of the transactions that are cleaned? what is the basis for triggering a cleaning process?...) . Already existing mandatory reporting are requested to a lot of institutions and mainly individual banks. It could be considered to request consolidated reportings to clearing houses or clearing agents which are not so numerous in Europe. This would make easier the building of a deal repository for analysis. In terms of methodology on Repos some interesting leads can be found in the Swiss National Bank Working Paper 2011-14 ”Bargaining Power in the Repo Market”1 which highlights how a repos market can be analysed with specifying segments and relative position from actors.**

In the process of developing a proposal for classifying assets for their market-liquidity, **we recommend that EBA takes the opportunity to:**

- compare the result of its classification process to the one the European Central Bank (ECB) applies for assets eligible to monetary policy. This will notably help in determining whether the approach that ECB has developed through its Liquidity Categories could be used to identify Liquid Assets, or at least could constitute an important input in the Liquid Asset categorization process;

- **determine whether or not there are enough Liquid Assets in Europe** for institutions subject to CRR to meet its LCR requirement, **including the other regulatory-driven-demand for similar assets such as the possible EMIR and Dodd-Frank requirements on collateral to post for derivatives;**

- make sure that the methodology does not lead to the exclusion of a too high portion of assets that are listed as potential liquid assets in the CRR (this applies notably to equities and Residential Mortgage Backed Securities (RMBS));

- check the resiliency of the methodology to upcoming changes in tax (FTT) and its consequences on EU-asset market liquidity;

- analyze the extent to which the methodology would be pro-cyclical (ie: assets that would cease to be eligible to Liquid Assets at the inception of a crisis).

Based on the draft CRR, our institution is currently attempting to answer the CRR requirement in defining Liquid Assets (ie: same challenge as the one EBA is currently facing). **We would be happy to share our analyses and our experience with EBA.**

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2. **Answers to Specific Questions:**

   a. **Q1:** Given the difficulties with obtaining transactional data outlined here, do you think a data sample cover 2008-2012 is sufficient for this analysis? Would you see merit in extending the sample in those countries where more data is available?

   Considering that market and asset classes are evolving over time, and that crises are not similar over time, no specific data sample will be perfect in the classification process. Many crises tend to look like unexpected cliffs: too much reliance on historical data may have unintended pro-cyclical effects, even when assuming that such data may be accessible.

   That is the reason why a judgment will be needed to complement/finalize the quantitative-based classification process.

   However, extending data to longer historical data would help analyzing the pro-cyclicality of the suggested method (ie: it would help back-test the methodology itself), which a very important issue to analyze.

   b. **Q2.** Do you have additional data sources to suggest? Specifically, can you suggest a source of repo data and gold that would fit our needs?

   As mentioned in our response to the EBA 2011 Consultation Paper on liquid assets, we recommend liaising with main custody and clearing entities (CSDs, ICSDs such as Euroclear and Clearstream), all or not facilitated through ICMA and/or ERC who have access to their expertise, their views and hopefully their data.

   We also suggest using publicly available data sources such as Bloomberg (notably its BVAL-Bloomberg Valuation Service), Reuters, Datastream, MTS, ION...

   As to gold we would refer to the London Bullion Market Association, which is still the primary market reference for gold trading worldwide.

   c. **Q3.** Do you agree with the list of liquidity metrics under consideration to be used in the EBA assessment, as mentioned in this section and Annex 5? Can you suggest further metrics the EBA should make use of, where information would be available?

   The additional metrics that should be used are:
   - The eligibility to Central banks
     - notably the ECB-Liquidity-categories,
   - General Collateral Basket inclusion on repos on Major CCPs,
   - asset-specific on repos traded on Major CCPs,
   - Over-The-Counter (OTC) repo market
   - fixed income trackers components (such as iBoxx, iTraxx...)
As for the suggested liquidity metrics:

- ‘*maximum bid/ask spread*’ shouldn’t be considered as there is no reliable data (bid/ask are simply not traded, and bid/ask are usually set to manage the order book of the market maker for limited order sizes while significant orders and transactions are executed Over-The-Counter without referring to quoted bid/ask spreads)
- ‘*remaining time to maturity*’ is not relevant when considering the other retained metrics (if the objective is to limit price volatility... the price volatility metric is already considered).
- ‘*minimum trade volume of the assets*’, ‘*average volume traded and average trade size (trade volume / number of trades)*’, ‘*minimum turnover ratio (trade volume / outstanding volume)*’ will prove difficult to gather data on.

**d. Q4. Do you agree with the list of explanatory characteristics whose linkage to liquidity it is proposed to be tested in the EBA assessment? Can you suggest further characteristics the EBA should assess?**

The explanatory metrics are very important to consider and should be complemented as described in our response to Q3:

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**e. Q5. Do you agree with the methodology proposed? Do you have alternative approaches that might be used?**

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