

To: EBA

by e-mail: EBA-DP-2013-19@eba.europa.eu

14 August 2013

EBA Consultation Paper on Draft RTS on additional liquidity outflows (CP/2013/19)

Dear Sir or Madam,

The Association of Danish Mortgage Banks (Realkreditrådet), The Danish Bankers Association (Finansrådet) and the Danish Mortgage Banks' Federation (Realkreditforeningen) appreciate the opportunity to comment on the draft Regulatory Technical Standards on additional liquidity outflows corresponding to collateral needs resulting from the impact of an adverse market scenario on the institution's derivatives transactions, financing transactions and other contracts for liquidity reporting.

General remarks

In general, we acknowledge the concept of having a liquidity buffer to cover additional collateral outflows resulting from adverse market scenario on institution's portfolio of derivative transactions etc. We also agree to an approach based on a stress of the value of those transactions. However, EBA's chosen approach on this rather specific area is very sophisticated compared to the general approach chosen in the LCR requirements. This mix of more or less sophisticated stress assumptions of the different components of the LCR might lead to inconsistency in the overall LCR calculation.

As an example, derivative transactions may be used to hedge liquid assets. If an institution has entered into a interest rate swap to hedge interest rate risk on a liquid asset the changes in value of the liquid asset due to same stress as applied to the swap is completely omitted – for some liquid assets a haircut is applied when included in the LCR no matter what. However, the changes in value of the asset and the swap might be off-setting.

Thus, we suggest that no stress (or a less severe stress) is applied on derivative transactions used to hedge liquid assets as defined in article 416 in CRR.

Answers to specific questions

Q1: Is there any specific category of contracts subject to this Regulation that could only lead to immaterial additional outflows? If so, could you explain why and clearly specify the type of contract?

No comments.

Q2: 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 us with an alternative specification.

No comments.

Q3: Would your institution face additional collateral outflows from securities financing transactions for other reason than a decline in value of the collateral? If yes please provide us with a detailed description on the type of contract, the reason for the outflow and the approximate volume.

Cross-currency repos (where cash- and bond-leg are in different currencies) is sensitive to FX-rate.

Q4: Are paragraphs 2c and 2d sufficient for reducing incentives for cherry picking behaviour? Are there other specifications that could help this purpose?

No comments.

Standard Method:

Q5: 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?

Several aspects need to be clarified or described more detailed:

- It should be clarified that the calculation only includes transactions covered by a collateral agreement of some kind.
- A description should be made regarding if - or how - consolidation is done (see answer to Q20).
- Regarding the definition of a margining set: If a collateral agreement has a build-in threshold, meaning an initial unsecured exposure level, for which no collateral is posted, will this agreement then qualify as a margining set?

*Example: Threshold 10 million and Minimum Transfer Amount (MTA) 1 million.
When the market value of the portfolio reach
9 million, a collateral posting of 0 million is required,
10.5 million, a collateral posting of 0 million is required, or
11.01 million, a collateral posting of 1.01 million should be made.*

If not: How large MTA-amounts are acceptable to qualify for article 2 (2) (a): ...to fully cover such changes in value.

- Does “immediate” - in relation to outflows or inflows – mean “same day” or are standard payment terms accepted based on standard ISDA/CSA (calculate exposure based on end-of-day, and agreement on transfer amount for tomorrow)?
- The handling of transactions and aggregation of value increases and decreases “outside of a margining set” seems very cumbersome and in some cases harsh. This is a serious issue:

As we are considering transactions covered by collateral agreements, they are also, for most parts, covered by an underlying netting agreement (meets requirement in article 2 (2) (b)) which calls for a more straight forward method for the calculation. We interpret the current description as if transactions outside of a margining set, which contribute with inflows, can only be included in the calculation, if they, in general, can be considered as usable inflow (article 2 (1) (g)). But they should at least be allowed to net against outflow under the same netting – and collateral - agreement.

Collateralized transactions not covered by a netting agreement do indeed require the treatment in the current description.

- Under which criteria do we order the currencies relative to ‘second most important’, ‘third most important’?

Q6: What transactions and contracts are you aware of that are sensitive to changes in multiple risk factors? How material are they to your institutions stock of assets of extremely high and high liquidity and credit quality as calculated in accordance with Part Six of CRR? Does the standard method capture these adequately? If not, what alternatives would you consider necessary to ensure they are appropriately incorporated?

It should be possible to eliminate the second iteration of the calculation, if the financial institution can argue, that the effect of the additional effort is below a ‘relevance level’ and hence immaterial.

Using the standard approach means that the calculation of outflows is not nearly an exact science, hence the error introduced by skipping the last iteration will be minor for financial institutions with simple portfolios, but the saving on the operational effort in implementing it, will be significant.

Q7: How do you view the restriction in paragraph 3 that only additional inflows of assets of extremely high liquidity and credit quality can be recognised outside of margining sets? To what extent do assets of typically lesser liquidity constitute part of collateral flows for your institution? What assets are they? Do these assets typically comprise outflows, inflows or both? How material is it for the LCR of your institution?

We agree in the approach of the restriction that only inflows in form of liquid assets can be recognised outside margining sets. However, we do not understand why this should be limited to only extremely high liquidity (so called level 1 assets) and excluding (less) liquid assets (so called level 2 assets).

Any such “restriction of a restriction” contributes to the phenomenon of top-collateral crunch and doesn’t seem more justified in this approach. Instead all inflows from liquid assets optionally after appropriate haircuts should be recognised outside margining sets.

Since the definition of extremely high or high liquid assets is not yet clarified it is difficult to quantify any material effects of only recognising inflows of assets of extremely high liquidity outside margining sets.

Q8: What are the expected implementation costs of the standard method and what is the time you would need for implementation? If possible, please compare it to the implementation costs of the other methods.

An implementation of the standard method as currently outlined will require significant development costs and the implementation time is expected to be approximately 3-6 months. An implementation of a more simplified approach however, should take less than a month.

The standard approach can be simplified by allowing the use of transaction sensitivities (bpv) scaled by the size of the shift, to obtain the in-/decrease in market value. This approach can replace the re-valuation, whenever a transaction has a linear payoff, and hence significantly reduce the cost of the implementation. It should be considered to allow for this possibility when a financial institution can argue, that for certain instruments/transaction types, the difference between a re-valuation and a shift based on trade sensitivities shows no material difference (example: IR-swaps can be handled by shifting trade-bpv, whereas FX options must be re-valued).

Q9: What impact in terms of liquidity coverage requirements do you foresee of the application of the standard method on your institution?

A significant increase in net cash outflows of approximately 20-50%.

Q10: How would you view an insertion of a special foreign exchange rate shock for currency pairs between the Euro and a currency participating in the ERM II? If positively, what shock factor would be appropriate, taking into account compulsory intervention rates?

It would make more sense than the current scenarios for currencies such as DKK which is pegged to the EUR at a very narrow spread (+/- 2.25%). Historically the volatility of EUR/DKK is by far even less than +/- 2,25%¹. However, taking into account the possibility of a centralbank intervention within the spread an appropriate shock factor seems to be 2.25%.

¹ Max. 30-day volatility of EUR/DKK since 2000 is 0.64%.

Simplified Method:

Q11: 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 outflow factors for long interest rate swaps is quite harsh. By comparing the re-valued (OECD) market value changes to the outflow factors, the difference seems to increase the longer the time to maturity. This seems too conservative, since the simplified method in addition allows no netting.

Hence the increment should be less than 1% per additional year and decrease over time.

Q12: What are the expected implementation costs of the simplified method and what is the time you would need for implementation? If possible, please compare it to the implementation costs of the other methods.

An implementation of the simplified method will probably only require limited costs and could be done in around one month.

Q13: What impact in terms of your institutions liquidity coverage requirement do you foresee for the application of the simplified method? How would this compare to the 5% threshold that is specified in paragraph 1 article 3?

Expectedly, most larger institutions with a “normal” derivatives portfolio will face a paramount increase in net cash outflows and thus not within the 5% threshold.

Q14: Would a special treatment of the narrowest of the currency pegs of the ERM II be appropriate? If so, what shock factor would be appropriate?

See answer to Q10.

Internal-model based / Unexpected Negative Exposure (UNE) Method:

Q15: 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?

No comments.

Q16: Please provide details of what adjustments in the implementation of your EPE model to be considered for the estimation of additional collateral outflows?

No comments.

Q17: What are the expected implementation costs of the EPE based advanced method and what is the time you would need for implementation? If possible, please compare it to the implementation costs of the other methods.

No comments.

Q18: What impact in terms of liquidity coverage requirement do you foresee of the application of the internal model based method on your institution?

No comments.

Q19: How would you view the development of a method based on VaR for the purposes of estimating additional collateral outflows? Could you review this in the context of the abovementioned difficulties?

No comments.

Consolidation:

Q20: Do you foresee any difficulties in calculating the consolidated estimates? If so, what are these difficulties and why do they arise? How material are they? What would be an appropriate alternative treatment?

The handling of consolidation is still unclear.

It should be described if a consolidation, under the standard method, requires additional iterations regarding selection of 'a joined shift' and recalculation of outflows or if it can be made as an aggregation of underlying outflows, even though these might not stem from the same scenarios.

Please keep in mind, that the calculation on individual level itself demands considerable resources. It should be strongly considered whether an additional iteration would contribute to the quality of the output relative to the effort. Also, this method is based on standardized scenarios and is hence not an exact science.

Also further clarification is needed regarding how to handle intra-group transactions after the selection of shifts in the standard method. Should intra-group transactions be excluded on consolidated level?

Historical look-back approach:

Q21: How would you like to see the historical look-back approach calibrated? Please provide details together with a justification.

No comments.

Q22: Should the method be focused on calendar months or utilize a moving 30 days window? Should the method be based upon full calendar years or be moving with a 24 months window?

No comments.

Q23: Is the method sufficiently resilient against potential future changes in volatility and against potential future changes in the size or characteristics of a bank's derivative portfolio? If not why and how could any such deficiency be addressed?

No comments.

Impact assessment:

Q24: 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?

No comments.

Yours sincerely

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