European
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EBF COMMENTS ON CEBS' TECHNICAL ADVICE ON LIQUIDITY RISK MANAGEMENT

GENERAL COMMENTS

1. Well before the 2007-2008 events supervisors and banks were already in agreement that supervisory practices in the area of liquidity risk management had become obsolete as they were overly focused on imposing quantitative requirements and, moreover, tended to ignore that cross-border banks need to be able to manage their liquidity on the basis of a group-wide approach.

   Furthermore, the financial turmoil has made it obvious that **banks also need to reconsider their liquidity risk management practices in a basic way** against the backdrop of an unfavourable liquidity environment.

   In general, the various recommendations made in **the CEBS' document address all issues that are relevant and correspond with the current thinking of the industry** on the matter. Although the main focus of the CEBS' document is on banks' and supervisory practices, the industry's expectation is that it will contribute to bringing more convergence in the approaches used in the supervision of liquidity risk management within Europe over time.

2. The main message, which was conveyed in a paper issued by the International Institute of Finance in 2007, was that **firms' needs and strategies can, for legitimate business reasons, vary considerably** so that any Recommendation which may be made must be understood as describing a range of good practices and, therefore, not as a prescriptive list of necessarily "best", detailed practices.

   We, therefore, welcome the reference which is made in the CEBS' document to the principle of proportionality as an overarching principle. This provides room for flexibility and should restrain individual supervisors from interpreting the various recommendations which are being made in an overly prescriptive way. It is essential that there is an open dialogue between firms and supervisors when examining the specific situation of each firm.

3. **The willingness to accept internal methodologies as potential substitute to quantitative supervisory requirements is particularly welcomed**. This is in line with a proposal made by the EBF and the IIF and would contribute substantially to promoting an efficient convergence of internal risk management and supervisory requirements. It is extremely encouraging that CEBS is more flexible on this than the Basel Committee.

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4. The reference which the document makes to the concept of materiality is extremely helpful.

DETAILED COMMENTS ON THE CEBS' PAPER

1. **Liquidity has a cost**. The recommendation made that institutions should have in place an adequate internal liquidity cost/benefit allocation with a view to assigning appropriate incentives relative to the risk undertaken is, therefore, highly appropriate..

   However, as implicitly recognised in the CEBS document, internal transfer pricing is merely only one of the possible means which are available to incorporate liquidity cost.

2. According to Recommendation 11 intraday liquidity should be managed on a gross basis. Our understanding is that this does **not imply that banks would be expected to add up all outflows, which are expected to occur during the day as sufficient collateral to secure all outflows for each participant is not available**. Moreover, such a requirement would not take into account that all payments and securities settlement systems have been secured to face the failure of major participants and that the safeguards put in place have been validated by the competent authorities.

   The idea behind Recommendation 11 is apparently rather that banks should be aware of possible risks involved in the management of intraday liquidity, monitor them closely and ensure they have adequate collateral readily available in the payment systems or sources of additional collateral should difficulties emerge in the payments systems used.

3. The document highlights the importance of banks making appropriate disclosures on their liquidity position, whilst implicitly recognising that disclosing detailed quantitative information on liquidity is an extremely sensitive issue as any misunderstanding which it might create may have devastating consequences for the institution.

   As observed in the document (under paragraph 208), the issue is where strategic or internal information ends and public information (for stakeholders) begins. We would like to add, moreover, that **disclosures made on a routine basis under normal conditions provide institutions with less flexibility when the market is under stressed conditions**. However, the wording of Recommendation 18 itself – and, in particular, the second sentence ("The nature, depth, and frequency of the information disclosed should be appropriate for their different stakeholders …") - does not reflect these caveats.

4. According to Recommendation 28 "*Supervisors should have at their disposal precise and timely quantitative and qualitative information which allows them to measure the liquidity risk of the institutions they supervise and to evaluate the robustness of their liquidity risk management.*"

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However, the clarification provided in the document encourages supervisors to explore the possibility of developing a minimum set of common reporting requirements, applicable to all credit institutions (see paragraph 250). We agree that banks should transmit quantitative data on their liquidity positions to their supervisor. However, as banks should be allowed to manage liquidity risk on the basis of internal methodologies, **banks should also be allowed to transmit to supervisors the quantitative data which the bank's liquidity manager has obtained from the bank's internal reporting system**.

5. Recommendation 29, which invites the authorities involved in supervising a cross-border banking group to coordinate their work, is welcomed in principle. However, the aim of this coordination should not, as envisaged in the recommendation, be confined to gaining a better understanding of the group's liquidity risk profile. As liquidity risk is increasingly being managed at group level, it would be essential to avoid contradictory requirements and costly duplication of work. Therefore, the authorities involved should not only exchange information and closely cooperate when supervising cross-border groups but also and **foremost achieve a common understanding of how liquidity is being managed at the level of the group**.

6. The wording of Recommendation 5 – which states that "the adequacy of IT systems should be reviewed regularly" – needs to be amended as it would seem rather that IT processes supporting of liquidity risk management should be reviewed regularly.