BANK · VERSICHERUNG

Division Bank and Insurance
Austrian Federal Economic Chamber
Wiedner Hauptstraße 63 | P.O. Box 320
1045 Vienna
T +43 (0)5 90 900-DW | F +43 (0)5 90 900-272
E bsbv@wko.at
W http://wko.at/bsbv

CEBS
liquidity@c-ebs.org

Your ref., Your message of	Our ref., person in charge	Extension	Date
	BSBV 115/Dr.Ru/Br	3137	13.10.2009

Re: **CEBS's CP on Liquidity Buffers & Survival Periods**

The Bank and Insurance Division of the Austrian Federal Economic Chamber representing the entire Austrian banking industry appreciates the possibility to comment on CEBS's consultation paper on liquidity buffers & survival periods and would like to submit the following position:

1) If the composition of liquidity buffers was to be restricted to assets that are both highly liquid in private markets (including in stressed time) and eligible central bank:

1.1 Would you foresee any shortage of eligible assets, such as government bonds, or any increase in the concentration or cost of holding such assets? Any impact on less liquid assets?

Given the proposed, restricted definition of the liquidity buffer, a combined idiosyncratic and market-wide scenario needs to be defined in a very balanced manner. If both are set at very severe levels, e,g. idiosyncratic equal to a multi-notch LT downgrade in combination with the market-wide scenario assumption that only highly rated government bonds are marketable, then this might create a limited survival horizon or would require a disproportionally large high quality Liquidity Buffer consisting of assets yielding significantly less than the institutions costs of funds. Especially under a combined scenario the regulatory framework should not prevent an institution from using less liquid eligible collateral as one of its first defence lines.

It should be noted that in the previous period, we witnessed that also for highly rated government bonds the private market was not able to provide continuous liquidity. Hence the notion that some securities will continue to be highly liquid in stress situation may be illusive. Consequently, Central Bank eligibility should be the main criteria for the composition of the liquidity buffer.

By introducing a restricted definition of the Liquidity Buffer, the European Financial institution may need to recalibrate their holdings in order to meet the CEBS guidelines. This may create additional demand for qualifying securities, resulting in lower yields and thus will have a significant impact on the costs of doing business. Furthermore, any holdings of securities not meeting the restricted criteria will become even less liquid and as a consequence are to be kept to maturity.

1.2 Would you expect any potential pressure points due to possible inconsistencies in the definition of the liquidity value of eligible collateral and the liquidity value of assets/collateral taking into account in the computation of the net cash outflow?

Yes, only when central bank activities are used as collateral can cash-flow be generated. In case of repo business or when selling liquid assets, +1 day for cash flow has to be considered.

1.3 What conditions, if any, should be fulfilled in your view before a narrow definition could be applied, without undue side effects? (for example: availability of collateral, transition arrangements including its length, etc.)

As stated earlier, a narrow definition will lead to asset reallocation for all EU domiciled banks. Not knowing the amount involved, it is difficult to judge how much time will be needed for the sector to adjust without distorting the market. Anyway, a transition period of a couple of years would be necessary to ensure that most of the collateral that does not meet the narrow definition has matured and can be substituted by the qualifying securities.

We are afraid, that “narrow definitions” would have negative impacts on liquidity managers’ flexibility.

2) Would you consider that a too narrow definition of assets eligible to the buffers could entail a possible sub-optimal allocation of means from a macro-economic perspective? Would you see a risk of wrong incentives? Please specify, if observations/expectations refer to particular markets.

Different country ratings might lead to an imbalance of demand for government bonds a/o countries with a lower rating. This will create undue side effects and may negatively impact the economy of these lower-rated countries. An upcoming crisis in a particular country could lead to a tightening of the situation as markets for this issue will dry out. One prerequisite for the classification of government bonds would be that all issues of EU sovereigns are treated the same way in order to avoid any concentration of liquidity buffer in specific issuing countries and impede sufficient diversification.

3) How would you assess the reference to central bank eligibility for the purpose of specifying which assets should be eligible to the liquidity buffers?

It is an economic reality that central banks are the only institutions able to create liquidity when private markets fail. Therefore financial institutions must have access to an alternative route to liquefy the assets in the liquidity buffer when private markets fail. Therefore, it is a necessary condition that assets in the liquidity buffer are central bank eligible. Central bank eligible collateral will give the institution the required flexibility in case of a financial market crisis. Liquidity buffers should be categorized in short-term and long-term buffers. Longt-term buffers should also include less liquid assets which might even not be central bank eligible. In an idiosyncratic stress scenario such assets could still be sold into the (still functioning) market as the quality of the asset itself is not negatively effected.

20. In addition, feedback on the general economic impact of the proposed Guidelines would be most appreciated. The questions listed below could help in this respect:

a. How does the return on liquid assets compare to the return on less liquid assets? Do you anticipate a (significant) impact on ROE?

There will definitely be a negative impact on overall ROE as decreases in government bonds will not be offset by yield increases of other bonds in a well diversified portfolio. This impact would increase costs especially for credit institutions with lower ratings. Furthermore, assets already held but not qualified for any buffer could lose value immediately due to potential widening of the spread.

b. Do you believe that CEBS's proposals could lead you to restrict your lending capacity or increase the cost of financing for borrowers?

There are potentially two effects:

1 Potential increase of required size of buffer to meet a combined scenario with a 1-month horizon: funding used to finance the increase of buffer can not be used for lending to customers

2 As previously stated, this narrow definition will affect the costs of doing business and this will impact all stake holders. Effectively, the proposal will increase the costs of a liquidity mismatch, depending on the applicable transfer price policy it may be directly charged to the individual transaction or included in the allocated liquidity mismatch cost of the business.

c. Do you foresee any impact of these proposals on your business models or activities? Do they present any level playing field issues with competitors other than credit institutions?

It will not necessarily change the business model. Nevertheless, the changed cost structure will impact individual businesses and may flip a marginally profitable business into a loss-making business. The managerial response on this may differ per business/product mix. Regarding competitors, there might be negative impacts of the yield of portfolios of insurance companies and investment funds in case of investments in high liquid assets.

d. Do you consider that these Guidelines can help to restore confidence in the interbank market? To improve funding costs?

For money market trading between banks these guidelines could have negative implications:
Collateral which was used now for interbank repo business might be blocked for a liquidity buffer.
Collateral used for central bank activities might be blocked for the buffer which will restrict access to cheap funding (based on pre-Lehman levels).
Available liquidity currently traded between banks might be used for investments into long-term securities and therefore withdrawn from the money market.
However, guidelines which give incentives to invest in a higher fraction of highly liquid portfolios should improve confidence between banks and could lead to higher trading activities based on restored credit limits. Guidelines on their own, however, are not expected to be sufficient measures. A better economic environment without loss expectations for the banking sector is key. In that respect a wide variety of actions from regulators and politicians is required.
Funding costs will definitely go up.

Remarks to special issue regarding cross border use of collateral:

Definition liquidity buffer and survival period
The liquidity buffer should serve to bridge the gap between stressed conditions and business as usual within a specific survival period. In our opinion, the liquidity buffer should cover the survival period for the short- to medium-term under business-as-usual conditions and the liquidity buffer for stress scenarios should cover at least the short survival period. Here too, the underlying stress scenarios are the determining factors. Using an equation the liquidity risk tolerance can then surely be calculated.

Guideline 5
With regard Guideline 5 we feel that the current arrangement under sec 25 Austrian Banking Act (BWG) for second-degree liquidity represents an obstacle to the use of assets in stress situations. In most cases, the assets eligible for central bank financing, borrowing and security-backed loans (repos) also serve as cover assets for the requirements set forth by sec 25 BWG. If these securities are sold to generate liquidity in a stress scenario, the provisions under BWG cannot be met even though assets are available for the generation of liquidity and hence for the maintenance of the institution's solvency.

Industry views would also be particularly helpful on the level at which buffers should operate within cross-border banking groups (GL6).

The use of collateral available in legal entities of international (exceeding EU area) operating banking groups is heavily affected by local legal regulations and local requirements. Collateral transfers within banking groups and a centralized liquidity management approach are hampered which leads to a lack of efficiency in liquidity and collateral management at group level. As a consequence, a variety of local setups are in place in order to fulfil local regulations. Cross-boarder use similar to the set up in the ECB area would be helpful in order to optimize liquidity management at a group level in order to account to a strengthening of financial markets in crisis situations.

Yours sincerely,

Dr. Herbert Pichler
Managing Director
Division Bank & Insurance
Austrian Federal Economic Chamber