Allied Irish Banks p.l.c. response to the EBA discussion paper 'On Defining Liquid Assets in the LCR under the draft CRR'

AIB welcomes the opportunity to engage with the EBA on this very important subject and within our reply would like to primarily focus on a specific area, the potential differentiation within sovereign bonds

<u>Question 1:</u>
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?

AIB agrees that the sample cover period of 2008 to 2012 is sufficient. The period covers the liquidity crisis and should highlight the liquidity of asset classes in a stressed environment.

<u>Question 2:</u>
Do you have additional data sources to suggest? Specifically, can you suggest a source of repo data and gold that would fit our needs?

With regard to Repo activity, Central banks are a further source of data, both from the perspective of monitoring the market activity of reporting institutions and from the viewpoint of bilateral activity between institutions and their central bank.

<u>Question 3:</u>
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 list of liquidity metrics is derived from Article 481.2 of the Draft CRR, however we would suggest a further metric. A key element of the current market is whether an asset is eligible at the ECB. Therefore ECB eligibility should be a liquidity criteria in any analysis. The reality in the current stressed market and in any market in the future is that the role of the central bank has been shaped such that it is now a part of the market and central bank eligibility should not be ignored as a factor. Within ECB eligibility it would be reasonable to consider assets which are eligible for regular open money market operations but not to consider assets that are only eligible for emergency facilities.

In the 6/1/13 update of the LCR calculation criteria, Paragraph 23 of 'Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools' states 'In order to qualify as HQLA, assets should be liquid in markets during a time of stress and, ideally be central bank eligible.' Also paragraph 26 states ' HQLA should ideally be eligible at central banks for intraday liquidity needs and overnight liquidity facilities……….Central bank eligibility should thus provide additional confidence

that banks are holding assets that could be used in events of severe stress without damaging the broader financial system'.
We would contend that these statements give weight to the proposal to include Central Bank eligibility as a further liquidity measure noting paragraph 27 that 'central bank eligibility does not by itself constitute the basis for categorisation of an asset as HQLA'.

It would seem incongruous to ignore ECB eligibility when the market actually focuses on it as a measure. We have concerns regarding differentiation within asset classes which we elaborate in the reply to Q5.

Question 4:
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 list provided is comprehensive. Each extra characteristic when overlaid with the 8-10 metrics adds further complexity to the assessment of liquidity.

We would like clarification as to how the EBA proposes to treat an asset once it has been assessed, does it have to hit all 8-10 metrics? If not what sort of combination is proposed? Where analysing within classes, are EBA proposing that level1 and level 2 assets may emerge or does the overall classification as level 1 maintain for all within that class, (though haircuts may apply thereafter).

Question 5:
Do you agree with the methodology proposed? Do you have alternative approaches that might be used?

We have concerns with the proposal to differentiate within asset class and in particular within European sovereigns. We query whether sovereigns should be part of this analysis given the following Basel III and CRD IV references to liquidity criteria and risk weighting calculations

The "Basel III: The liquidity coverage ratio and liquidity monitoring tools – January 2013" paper, defines Level 1 assets in paragraph 50 points (a) to (e). Specifically, point (c) defines marketable securities and points (d) and (e) allow for the inclusion of non-0% sovereign bonds.

Basel III is making a distinction between <u>marketable securities</u> which have to meet the criteria/conditions of being traded in large, deep and active repo and cash markets and so proven reliable source of liquidity in times of stress and <u>non-0% sovereign bonds</u>, presumably less marketable securities but which still qualify as Level 1 assets if issued in the same currency in which the liquidity risk is being taken.

Similarly, within 'CRD IV Article 404 – reporting on liquid assets'. Paragraph 1 while outlining the criteria for a liquid asset under points (a) to (d), clearly identifies under point (c), 'transferable assets representing claims on or guaranteed by the central government of a member state …'

Furthermore it appears unnecessary to delineate within Zone A central government and central bank assets as per "Annex vi Part 3 Risk Weightings point 12 (b) of the CRR draft document" Zero weighting applies to 'asset items constituting claims on Zone A central governments and central banks'

Similarly under 12(f) Zone B central governments and central banks denominated and funded in the national currency common to the guarantor and the borrower.

Taking the above references into consideration, the methodology on defining high quality liquid assets as set out in the Discussion Paper 'On defining highly liquid assets in the LCR' 21st February 2013, should apply only to securities/bonds other than sovereign securities/bonds or sovereign securities/bonds issued by the bank's home country or currency in which the liquidity risk is being taken.

With reference to the above we wish to clarify that European sovereign bonds (which include Irish Sovereign bonds) are

1. Automatically deemed a level 1 HQLA in all Euro zone jurisdictions i.e. Irish Sovereign bonds are Level 1 HQLA in Ireland and France, Germany etc.
2. Are therefore exempt from the proposed analysis

We suggest that without review, the proposed methodology could potentially introduce the concept of 'wrong way' risk. We contend that ECB eligibility mitigates against 'wrong way' risk and is a further reason to include ECB eligibility as a liquidity factor.