

EBA's consultation on currencies with constrained availability of Liquid Assets (EBA/CP/2013/37, EBA/CP/2013/38 & EBA/CP/2013/39)

Submission from the Banking Stakeholder Group of the EBA

The Banking Stakeholder Group (BSG) of the EBA welcomes the opportunity to comment on the EBA consultation papers related to:

- Currencies with an extremely narrow definition of central bank eligibility (EBA/CP/2013/37):
- Currencies for which the justified demand for liquid assets exceeds the availability of those assets under Article 419(4) of Regulation (EU) 575/2013 (Capital Requirements Regulation – CRR) (EBA/CP/2013/38):
- Derogations for currencies with constraints on the availability of liquid assets (EBA/CP/2013/39)

We would like to highlight the following general observations:

Alignment with European Liquid Asset definition

The EBA report on currencies with constrained availability of Liquid Assets will be released before June 2014 when the delegated act on LCR is published. Hence, the EBA will not be able to take into account the effects of its own recommendations to the European Commission on the definition of Liquid Assets categories within the LCR-buffer. The BSG strongly suggests that the EBA retain the option to update its analysis as soon as its own recommendations are known and where appropriate embed these into its analysis. We particularly urge the EBA to reconsider its decision to classify Norwegian covered bonds as illiquid. We do not consider this assessment on a stand-alone basis appropriate and request an alignment of the assessment of covered bonds in a broader perspective in Europe.

Identification of currencies with a shortage of Liquid Assets

Of the possibly wider range of currencies which could have a shortage of Liquid Assets only DKK and NOK have been analysed by the EBA. In this regard it should be clarified by EBA that it will ultimately be left up to national supervisors to identify if the local currency should be defined as lacking Liquid Assets and if so how this shortage should be addressed.

Additional haircuts on derogations

Banks with activities in jurisdictions with deficits of available Liquid Assets, as defined by regulators, will face a double penalty since not only will the use of derogations be capped but also be subject to additional haircuts. BSG agrees that banks

should not have economic incentives to make unnecessary use of derogations but this should not lead to a competitive disadvantage for banks operating in these jurisdictions.

Regarding the appropriateness of an additional 8% haircut for foreign currency denominated Liquid Assets, the BSG feels that it is unduly harsh and inappropriately calibrated as it fails to take into account (i) that currency risk can be hedged with cross currency swaps, FX-swaps, forwards or options (as addressed by Article 418(1)), and (ii) that even unhedged foreign currency denominated holdings will benefit from a risk-reducing correlation between local liquidity stress and the foreign exchange rate. Taking NOK as an example it can be shown that in case of a liquidity stress NOK historically depreciated strongly vs. the global reserve currencies USD and EUR (as exemplified in 2008-2009) so that banks holding foreign-currency denominated liquid assets would benefit when converting these into their home currency.

Methodology of estimating the Liquid Asset shortfall

The EBA uses its estimation of Liquid Asset shortfall as a constraint for the use of derogations. Depending on the assumptions chosen the range of the calculated shortfall is very wide varying between 47% and 83% in NOK. The BSG believes that the use of derogations should not be limited solely by a criterion where the methodology gives rise to such wide variations. In addition, it is worth pointing out that public data from Norway suggest that the share of government bonds owned by foreign investors, and thus deemed buy-and-hold by EBA, was close to 50% as of June 2012. This is considerably larger than the 20% used by EBA and would give rise to a much larger shortfall of Liquid Assets.

Classification of Norwegian covered bonds as illiquid

The BSG disagrees with the classification of Norwegian covered bonds as illiquid. As recognized by EBA the asset class has gained importance in Norway over the last years and the covered bond market (over NOK 500bn) has overtaken the government bond market in size, shows much lower volatility and less price impact from bond trades than the government bond market. EBA's analysis seems to be based primarily on what it considers low trading volumes. This disregards not only the better volatility metrics of the covered bond market but also fails to take into account that supply side liquidity has improved markedly with issuance taking place almost on a daily basis and that the increased repo market activity is being further developed by the Norwegian banking sector. The BSG therefore suggests that Norwegian covered bonds are deemed Liquid Assets under the LCR.