



EBA/ITS/2014/01

28 March 2014

EBA FINAL draft implementing technical standards

On currencies for which the justified demand for liquid assets exceeds the availability of those assets under Article 419(4) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)

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Abbreviations

BCBS	Basel Committee on Banking Supervision
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
DKK	Danish Krone
ITS	Implementing Technical Standard
LCR	Liquidity Coverage Ratio
NOK	Norwegian Krona
RTS	Regulatory Technical Standard
SFT	Secured Financing Transaction

1. Executive summary

The Capital Requirements Regulation (CRR) sets out prudential requirements for liquidity, applicable as of 1 January 2014.

The CRR contains specific mandates in a number of articles for the EBA to develop draft regulatory or implementing technical standards (RTS and ITS) relating to liquidity requirements. These standards will be part of the 'single rule book' enhancing regulatory harmonisation in the European Union.

Main features of the ITS

In these final draft ITS, the EBA lists the currencies with constraints on the availability of liquid assets pursuant to Article 419(4) of the CRR. For these currencies, the justified needs for liquid assets in light of the liquidity coverage requirement in Article 412 of the CRR exceed the availability of those liquid assets in a currency. In accordance with Article 419(2) of the CRR, two types of derogations shall apply for these currencies. The derogations are intended to address the inherent difficulties that institutions would face in meeting their liquidity coverage requirement in such currencies where it is not possible to reduce, by sound liquidity management, the resultant need for liquid assets and the holdings of those assets by other market participants. In parallel to these ITS, the EBA has also developed and finalised final draft RTS under Article 419(5) of the CRR to specify the use of the above-mentioned derogations.

In the final draft ITS the list of currencies has been specified on the basis of data gathered by the Member States and a set of assumptions that result in shortage estimates per currency. The data collection process has been completed for two currencies, namely the Norwegian krone (NOK) and the Danish krone (DKK), the results of which have determined their addition to the list. All competent authorities in the European Economic Area (EEA) had the opportunity to complete an assessment of whether or not there were constraints on the availability of domestic currency liquid assets, to determine the inclusion of their domestic currency in the ITS. However, for currencies other than NOK and DKK, a data-gathering exercise was either not undertaken or not completed for various reasons, primarily relating to the sufficiency of available domestic currency liquid assets or, in limited circumstances, because robust data and documentation to support such an analysis could not be obtained.

Currencies outside the EEA have not been included in the current evaluation, due to, inter alia, the need to focus on the most relevant currencies and constraints to data availability. In particular, estimates of the demand for liquid assets that the implementation of the Basel III liquidity coverage requirement would create for non-EEA jurisdictions are not easily available. In addition, the EBA considers it preferable to consider non-EEA currencies in the light of the assessments of constraints on the availability of liquid assets as performed by the relevant non-EEA jurisdiction itself.

To determine the supply of liquid assets, the EBA collected data from the Member States using the Basel definition of high quality liquid assets (HQLA), as laid down in Basel III: the liquidity coverage ratio and liquidity monitoring tools, January 2013 (the BCBS standards). The incorporation of the Basel definition is deemed necessary as a definition of liquid assets is not yet established within the context of the CRR. It naturally follows that the list of currencies with constraints on the availability of liquid assets produced by the EBA will have to be revised once a final definition of liquid assets at EU level has been developed and adopted by a delegated act from the Commission by 30 June 2014 in accordance with Article 460 of the CRR. The EBA's analysis will be repeated on a regular basis.

On the demand side, the Member States reported the estimated demand for liquid assets from institutions regulated by the CRR as the weighted net cash outflows over the next 30 days, taking into account the cap on inflows as specified in the BCBS standards. It should be noted in this regard that these estimates could exceed the demand for liquid assets resulting from the CRR due to an exclusion from the inflow cap of inflows referred to in Article 425(1) of the CRR. Under the ITS on supervisory reporting, for liquidity coverage requirements issued under Article 415(3)(a) of the CRR this information will be collected from 2014 onwards.

In the absence of a formal mandatory reporting requirement prior to the application of the CRD IV/CRR, estimated demand has been based on information reported in the EBA's voluntary reporting exercise and/or in the Quantitative Impact Study of the Bank for International Settlements (BIS). The latest reported information available during the assessment process was dated September 2012, so estimated demand did not reflect the changes in the BCBS standards of January 2013 or any possible behavioural effects that may materialise only once the liquidity coverage requirement is in place. For countries that did not participate in the BIS Quantitative Impact Study, the reporting of demand has been based on other available sources. To assess the amount of liquid assets locked up by investors not regulated by the CRR, the Member States reported holdings of liquid assets by these entities, and have provided evidence that these holdings are price inelastic but stable.

To ensure the robustness of the results, a sensitivity analysis has been conducted to account for uncertainties in the supply and demand figures. The analysis estimated, inter alia, the impact of potential deviations from the Basel definition of liquid assets and of scenarios in which the supply of government debt would grow. These analyses helped inform the EBA in its view that the abovementioned approach leads to appropriately robust results.

To keep the ITS up to date, the EBA will repeat its analysis whenever a change (or series of changes) occurs that is likely to have a major impact on the outcome. Such an event may include a material change in the outstanding amount of liquid assets (e.g. government bonds), the amount of assets locked up by institutions not subject to the CRR, or the aggregate net outflows of institutions subject to the CRR. The ITS will also be updated taking into consideration new currencies for which the data collection process has been completed. In any case, the analysis will be repeated after the EU Commission has established the calibration of the liquidity coverage requirement by a delegated act.

The EBA assessed the responses received once the consultation had closed on 22 December 2013. This assessment led to the conclusion that no changes should be made to the version of the draft ITS on which the consultation had been based.

The EBA has submitted the draft ITS to the EU Commission.

2. Background and rationale

Background and regulatory approach followed in the final draft ITS

In January 2013, the Basel Committee on Banking Supervision (BCBS) published its text of the revised Liquidity Coverage Ratio (LCR).¹ The objective of the LCR is to promote the short-term resilience of the liquidity risk profile of banks. It does this by ensuring that banks have an adequate stock of unencumbered high quality liquid assets HQLA that can be converted into cash easily and immediately in private markets to meet their liquidity needs for a 30-calendar-day liquidity stress scenario. It is intended that the LCR will improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source, thus reducing the risk of spillover from the financial sector to the real economy.

The BCBS identified that some jurisdictions may have an insufficient supply of HQLA in their domestic currency to meet the aggregate demand of banks with significant exposures in this currency. To address this situation, alternative treatments for holdings in the stock of HQLA may be applied to a limited number of currencies and jurisdictions. It is envisaged that eligibility for such alternative treatment will be based on meeting a set of qualifying criteria and will be determined through an independent peer review process overseen by the BCBS.

The CRR provisions relating to liquidity coverage requirements translate these BCBS proposals into EU law. The final draft ITS as put forward by the EBA are a direct result of the CRR provisions.

In accordance with Article 419(1) of the CRR, the EBA has assessed the availability for institutions of assets of extremely high liquidity and credit quality, as defined in Article 416(1)(b) of the CRR, in the currencies that are relevant for institutions established in the Union. In accordance with Article 419(4) of the CRR, the EBA has developed final draft ITS listing the currencies with constraints on the availability of liquid assets. In parallel, the EBA has also developed a final draft RTS under Article 419(5) of the CRR to specify derogations referred to in paragraph 2 of that Article, including the conditions of their application for currencies with constraints on the availability of liquid assets and listed in this ITS. The ITS and RTS, adopted under Articles 419(4) and 419(5) of the CRR respectively, must be read in conjunction with each other.

With these final draft ITS, the EBA has developed the list of currencies where the justified needs for liquid assets emanating from the liquidity coverage requirement in Article 412 of the CRR exceed the availability of those liquid assets in that currency. In this situation, one or more derogations may be applied. The derogations provide that:

- the denomination by currency of the liquid assets may be inconsistent with the distribution by currency of liquidity net outflows by derogation to Article 417(f) of the CRR;

¹ Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools - <http://www.bis.org/publ/bcbs238.htm>

- for currencies of a Member State or third countries, required liquid assets may be substituted by credit lines from the central bank of that country, which are contractually irrevocably committed for the next 30 days and are fairly priced, provided that the competent authorities of that Member State or third country do the same and that Member State or third country has comparable reporting requirements in place.

In addition to providing a list of currencies, the annex of the draft ITS also estimates shortfall percentages for these currencies as derived from the data-gathering exercise. These percentages indicate the estimated aggregate shortage compared with the aggregate demand generated by the liquidity coverage requirement for each currency in the list. In accordance with Article 419(3) of the CRR, the use of derogations for these currencies shall be inversely proportional to the availability of the relevant assets. To ensure that derogations are applied in this manner, the RTS developed under Article 419(5) of the CRR will specify a usage limit for the derogations that equals the shortfall percentage. Therewith, the aggregate estimated shortfall in liquid assets can be offset by allowing each institution to cover its individual net outflows by means of the derogation up to a limit emanating from the shortfall percentage.

Process of data collection

In the draft ITS, the list of currencies has been specified on the basis of data gathered by the Member States and a set of assumptions that result in shortage estimates per currency. The data collection process has been completed for two currencies, namely the Norwegian krone (NOK) and the Danish krone (DKK). All the EU Member States had the opportunity to complete an assessment of whether or not there were constraints on the availability of domestic currency liquid assets, to determine the inclusion of their domestic currency in the ITS. However, for currencies other than NOK and DKK a data-gathering exercise was either not pursued or completed for various reasons, primarily relating to the insufficiency of available domestic currency liquid assets or, in limited circumstances, because robust data and documentation to support such an analysis could not be obtained.

Currencies outside the EEA have not been included in the current evaluation, due to, inter alia, the need to focus on the most relevant currencies and constraints to data availability. In particular, estimates of the demand for liquid assets that the implementation of the Basel III liquidity coverage requirement would create for non-EEA jurisdictions are not easily available. In addition, the EBA considers it preferable to consider non-EEA currencies in the light of the assessments of constraints on the availability of liquid assets as performed by the relevant non-EEA jurisdiction itself.

To determine the supply of liquid assets, on the basis that the definition of liquid assets is not yet established within the context of CRR, the EBA decided to proceed using the Basel definition of high quality liquid assets (“HQLA”), as laid down in Basel III: The Liquidity Coverage Ratio and liquidity monitoring tools, January 2013 (the BCBS standards). It naturally follows that the list of currencies with constraints on the availability of liquid assets produced by the EBA will have to be revised once a final definition of liquid assets at EU level has been developed and adopted by a delegated act by the Commission by 30 June 2014, in accordance with Article 460 of the CRR.

The Member States reported the outstanding amounts (supply) of level 1, level 2a and level 2b assets, according to the specifications laid down in paragraphs 50–54 of the BCBS standards and sub-categorised by type of issuer and credit quality. The part of supply of these assets that was traded in large, deep and active repo markets was reported separately for each item.

Regarding the demand for liquid assets, the Member States reported the estimated demand for liquid assets from institutions regulated by the CRR as the weighted net cash outflows over the next 30 days, taking into account the cap on inflows as specified in the BCBS standards. It should be noted in this regard that these estimates could exceed the demand for liquid assets resulting from the CRR due to an exclusion from the inflow cap of inflows referred to in Article 425(1) of the CRR. Under the ITS on supervisory reporting, this information for liquidity coverage requirements issued under Article 415(3)(a) of the CRR will be collected from 2014 onwards.

In the absence of a formal mandatory reporting requirement before the application of the CRD IV/CRR, estimated demand has been based on information reported in the EBA's voluntary reporting exercise and/or in the BIS Quantitative Impact Study. Since the latest reported information available during the assessment process was dated September 2012, estimated demand did not reflect the changes in the BCBS standards of January 2013 or any behavioural effects that may materialise only once the liquidity coverage requirement is in place. For countries that did not participate in the BIS Quantitative Impact Study, the reporting of demand has been based on other available sources.

For investors not regulated by the CRR, the Member States reported the holdings of liquid assets that show price inelasticity but have been proved to be stable.

Finally, Member States provided documentation to support the figures and to analyse factors likely to affect the shortfall in liquid assets over a 3- to 5-year period.

Input data for currencies in the list

Norway

For Norway, the total outstanding amount of government debt at September 2012 was approximately NOK 500 billion (500 000 million). The Norwegian government debt market is assessed as being liquid.

International institutions and multinational development banks have issued large amounts of bonds in NOK. The total outstanding of these comes to some NOK 100 billion. However, these issues are predominantly private placements held by overseas investors and are therefore not considered liquid and available for institutions regulated by CRR.

In 2007 Norway passed a covered bond act. Since then, this market has grown considerably in size and now amounts to roughly NOK 400 billion. The market is still developing, but at present there is little trading taking place and the bonds are therefore not deemed to be liquid.

The Norwegian equity market is of a significant magnitude with a market cap of roughly NOK 1 200 billion (excluding equities issued by financial entities). The equities are traded actively outright and in repo markets.

Norway has liquidity reporting in place that resembles the Basel 2010 liquidity requirements covering all Norwegian banks. Norway therefore has significant data to substantiate the estimate of the demand for liquid assets in NOK by institutions subject to the CRR.

Denmark

For Denmark, the total outstanding amount of government debt amounted to DKK 850 billion by September 2012. The Danish government debt market is assessed as being liquid.

The Danish mortgage sector is by far the largest covered-bond-issuing sector. The total outstanding amount of covered bonds is just short of DKK 2 500 billion, of which more than DK 2 100 billion are AAA-rated. The Danish mortgage bonds are traded to a substantial degree and assessed as being liquid for the purposes of this assessment.

The market capitalisation of the constituents of the primary Danish equity index, excluding financials, is just under DKK 1 000 billion. The assumption has been made that holdings by large owners (of more than DKK 500 million) are not tradable, leading to a tradable amount of roughly DKK 700 billion. In the case of Denmark, however, the availability of equity seems to be largely irrelevant for the end results, given the large amount of highly rated covered bonds as indicated above.

Denmark has liquidity reporting in place and participates in the EBA voluntary monitoring exercise. Therefore, it has significant data to substantiate the estimate of the demand for liquid assets in DKK.

Methodology

In formal terms, currencies face constraints on the availability of liquid assets if:

$$(1) \quad A < D + B$$

where A is the availability to institutions of assets that are of extremely high and high liquidity and credit quality, D is the total demand for liquid assets generated by the liquidity coverage requirement as stipulated in Article 412 of the CRR, and B is a buffer – an excess supply of available liquid assets needed for markets to remain liquid and well functioning after the introduction of the liquidity coverage requirement, expressed as a percentage of demand. The assessment provides an estimate of the amount of free-floating assets required for a market to remain liquid, namely 25% of the total demand for liquid assets generated by the liquidity coverage requirement: $B = 0.25 * D$. This size of the buffer of free-floating assets is seen by the EBA as sufficient for institutions to be able to sell liquid assets in case of stress.

The availability to institutions of assets that are of extremely high and high liquidity and credit quality (A) can be expressed as:

$$(2) \quad A = \sum A(i) = \sum \sum (O(i) - L(i,j))$$

where $A(i)$ is availability for institutions of liquid asset i , $O(i)$ is outstanding amount of asset i and $L(i,j)$ is amount locked up of asset i by sector j .

Generally, the assets held by pension funds, insurance companies and central banks have been assumed to be 100% locked up.

Specifically for Norway, it has been observed that roughly one fifth of the government debt is held by foreign investors that are dominated by central banks and other buy-and-hold investors, amounting to roughly NOK 105 billion of government debt locked up. In terms of equity, the amount locked up by foreign investors amounts to roughly NOK 80 billion. The demand for liquid assets from Norwegian non-CRR-regulated parties is negligible.

Denmark has a fully funded pension system that, historically, has invested significantly in Danish government bonds. The total holdings of the pension and insurance sector, including the Danish Social Pension Funds, amount to some 40% of total outstanding government debt, amounting to roughly DKK 340 billion. The pension system investments in covered bonds are assumed to amount to roughly DKK 200 billion. Foreign investors, of which foreign central banks constitute a very significant part, hold nearly 20 % of the outstanding government debt, amounting to roughly DKK 161 billion. Foreign holdings of DKK-denominated covered bonds are found to be negligible.

The total demand for liquid assets generated by the liquidity coverage requirement as stipulated in Article 412 of the CRR (D) may be expressed as follows:

$$(3) \quad D = \sum cD(k)$$

where $D(k)$ is the demand from institution k when liquidity coverage requirement = 1, and c is a constant equal to or larger than 1, reflecting the fact that institutions may hold liquid assets in excess of the minimum requirement.

The assumption is that institutions aim to maintain, on average, a liquidity coverage requirement of 110%, which implies that c in the above formula is set at 1.1. Institutions may aim for a liquidity coverage requirement of above 100% because of, inter alia, uncertainty regarding future inflows and outflows as well as fluctuations in the market value of the liquidity buffer.

On the basis of the abovementioned data and assumptions, the EBA's assessment provided estimates of the shortfall in available liquid assets relative to the demand from institutions regulated by the CRR, that is: $(1 + (B - A)/D) * 100 \%$.

Results

On the basis of the process and methodology, the EBA has determined that the Norwegian krone (NOK) and Danish krone (DKK) are currencies with constraints on the availability of liquid assets. Specifically, the available liquid assets denominated in NOK are estimated to be 62% of the aggregate demand for liquid assets denominated in NOK from institutions, assuming that they target a 110% liquidity coverage requirement. The shortage without taking into account the 25% buffer for keeping

markets liquid equates to 38%, that is 100% - 62%. Incorporating the 25 % buffer would result in a 63% shortage of NOK compared with the aggregate demand for NOK-denominated liquid assets.

For DKK, the available liquid assets are estimated to be 98% of the aggregate demand for liquid assets denominated in DKK from institutions, assuming that they target a 110% liquidity coverage requirement. The shortage without taking into account the 25% buffer for keeping markets liquid will then be 100% - 98% = 2%. Incorporating the 25% buffer would result in a 27% shortage in DKK compared with the aggregate demand for DKK-denominated liquid assets.

Sensitivity analysis

To take into account uncertainties in the supply and demand figures for liquid assets, a sensitivity analysis has been conducted by shocking the various input variables. The analysis estimated, inter alia, the impact of potential deviations from the Basel definition of liquid assets, and of scenarios in which the supply of government debt would grow. These analyses helped support the EBA in its view that the abovementioned approach leads to appropriately robust results. Clearly, however, the results are significantly sensitive to the estimates and parameter values used in the methodology, in particular the assumptions that a buffer of 25% of demand is necessary for markets to remain liquid and that institutions target a 110% liquidity coverage requirement on average.

For Norway, in all the general scenarios, the availability of liquid assets falls well short of the demand from institutions, resulting in ratios ranging from a low of 47% to a high of 83% of available liquid assets as a percentage of demand for liquid assets. Further specific scenarios for Norway were also considered. First, the amount of issuance from international organisations and international development banks was assumed to be liquid and available to institutions. In this case, the ratio increases to 79%. The second scenario specific to Norway assumed a 40% cap on level 2b assets. In this case, the ratio rose to 88%, reflecting the considerable size of the Norwegian equity market.

Other scenarios considered include a change to the definition of level 1 assets to include the highest rated covered and corporate bonds, and changes to the cap on level 1 assets. These had no significant impact on the Norwegian case, as the highest-rated covered and corporate bonds in Norway are not assessed as being liquid. This assessment may however change depending on the European definition of asset liquidity, which may take into account supply-side liquidity.

For Denmark, the general scenario analysis shows the availability of liquid assets relative to the demand from institutions regulated by the CRR to be fluctuating around 100%, with the lowest ratio 74% and the highest 133%. Given the high ownership of government bonds by the pension and insurance sector, the ratio is clearly sensitive to changes in this figure, as is demonstrated in the first scenario specific to DKK. Here it is assumed that these holdings are reduced by 50%, and the ratio increases to 168%. Another scenario specific to Denmark assumes that the supply of government bonds is increased by DKK 50 billion in line with official projections for 2015. In this case, the ratio increases to 111%.

The scenario analysis also contains three scenarios analysing the consequences of applying a different definition of liquid assets as well as a different level of the cap on level 2 assets. If the cap on level 2 assets is raised from the 40% prescribed by the BCBS standards to 60%, the ratio increases to 148%. If there is no cap on level 2 assets or if the highest-rated covered and corporate bonds are

deemed level 1 assets, the ratio increases to 357% or 400%, respectively. The high sensitivity to these scenarios is related to the large size of the Danish covered bond market, which under the current BCBS standards is capped at 40% of the buffer.

To keep the ITS up to date, the EBA will repeat its analysis whenever a change (or series of changes) occurs that is likely to have a major impact on the outcome. Such an event may include a material change in the outstanding amount of liquid assets (e.g. government bonds), the amount of assets locked up by institutions not subject to the CRR, or the aggregate net outflows of institutions subject to the CRR. The ITS will also be updated taking into consideration new currencies for which the data collection process has been completed. In any case, the analysis will be repeated after the European Commission has established the calibration of the liquidity coverage requirement by delegated act.

3. EBA Final implementing technical standards on currencies for which the justified demand for liquid assets exceeds the availability of those assets under Article 419(4) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)



Brussels, XXX
[...] (2013) XXX draft

COMMISSION IMPLEMENTING REGULATION (EU) No .../..

of XXX

**COMMISSION IMPLEMENTING REGULATION (EU) No .../...
laying down implementing technical standards with regard to currencies with
constraints on the availability of liquid assets according to Regulation (EU) No 575/2013
of the European Parliament and of the Council**

COMMISSION IMPLEMENTING REGULATION (EU) No .../..

of XXX

**COMMISSION IMPLEMENTING REGULATION (EU) No .../...
laying down implementing technical standards with regard to currencies with
constraints on the availability of liquid assets according to Regulation (EU) No 575/2013
of the European Parliament and of the Council**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,
Having regard to Regulation (EU) No 575/2013 of 26 June 2013 of the European Parliament
and of the Council on prudential requirements for credit institutions and investment firms and
amending Regulation (EU) No 648/2012¹, and in particular Article 419(4) thereof,

Whereas:

- (1) The Basel Committee on Banking Supervision (“BCBS”) has established international standards regarding the liquidity coverage ratio and liquidity risk monitoring tools² (the BCBS standards). The BCBS standards establish guiding principles for assessing availability for institutions of liquid assets in currencies. In line with Principle 1 of the BCBS Standards, only currencies for which sufficient evidence is demonstrated should be considered as having constraints on the availability of liquid assets, and secondly, a methodology which takes into account all relevant factors affecting the supply of, and demand for liquid assets, should be established. Pursuant to Annex II of the BCBS standards, the methodology should take into account factors relating to the supply of liquid assets, the market for liquid assets, the demand for liquid assets by institutions, and demand for liquid assets by entities outside of the scope of Regulation (EU) No 575/2013.
- (2) In order to ensure that use of the derogations in Article 419 of Regulation (EU) No 575/2013 is inversely proportional to the availability of the relevant assets it is necessary to specify for each relevant currency the amount by which justified needs for liquid assets exceed availability.
- (3) Pending the adoption of a harmonised Union definition of what constitutes a liquid asset, the determination of a constraint on the availability of liquid assets should be based on the definition of high quality liquid assets adopted by the BCBS.
- (4) The assessment of justified needs should be based on the amounts of liquid assets outstanding, within currencies, that are not locked-up by entities which are not subject to the Regulation (EU) No 575/2013 and be compared to institutions’ estimated weighted net cash outflows over the next 30 days, taking into account the cap on inflows and factors likely to affect the shortage of liquid assets over a 3 to 5 year period. The assessment should also take into account the need for institutions to

¹ OJ L 176, 27.6.2013, p. 1.

² Basel Committee on Banking Supervision, Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools, January 2013.

be able to sell liquid assets in case of stress and should therefore provide for a buffer of 25% of estimated demand. Additionally the assessment should take into account the propensity of institutions to target a liquidity coverage requirement which exceeds 100%, and should therefore be based on a target of 110%.

- (5) The assessment should be based on the best available data that can be supplied by competent authorities to the European Supervisory Authority (European Banking Authority) (EBA) on liquid assets in a currency, locked-up amounts and institutions' liquid assets demands.
- (6) This Regulation is based on the draft implementing technical standards submitted by the EBA to the Commission.
- (7) The EBA has conducted open public consultations on the draft implementing technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010 of the Parliament and of the Council,

HAS ADOPTED THIS REGULATION:

Article 1

Currencies with constraints on availability of liquid assets

For the purpose of Article 419(2) of Regulation (EU) No 575/2013, the justified needs for liquid assets in light of the requirement in Article 412 of that Regulation exceed the availability of those liquid assets in the currencies specified in the table in the Annex by the percentage specified in that table.

Article 2

Final Provisions

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission

The President

On behalf of the President

[Position]

Annex

Currency	Amount by which justified needs for liquid assets exceed availability
Danish Krone (DKK)	27%
Norwegian Krone (NOK)	63%

4. Accompanying documents

4.1 Cost-benefit analysis / impact assessment

Introduction

1. Article 15(1) of the EBA Regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council) provides that when any draft implementing technical standards developed by the EBA are submitted to the European Commission for adoption, they shall be accompanied by an analysis of ‘the potential related costs and benefits’. This analysis should provide an overview of the findings regarding the problem to be dealt with, the solutions proposed and the potential impact of these options.

2. This note outlines the assessment of the impact of the draft ITS regarding currencies for which the justified demand for liquid assets exceeds the availability of those assets. The draft ITS are a result of the requirement set out in Article 419(4) of the CRR.

Problem definition

Issues addressed by the European Commission (EC) regarding liquidity management

3. In its impact assessment of the CRD IV framework, the European Commission noted that the existing liquidity risk management approaches and supervisory regimes inadequately captured risks inherent in the underlying market practices and trends. These shortcomings contributed to the failure of several institutions and greatly undermined the financial health of many others, threatening financial stability and resulting in unprecedented levels of central bank liquidity and government support.

4. The CRR proposes two minimum standards for funding liquidity to address this issue. One of these is the liquidity coverage requirement, which is intended to ensure that an institution has sufficient high quality liquid assets (HQLA) to survive an acute stress scenario lasting for 30 days. This requirement will help achieve the general objectives of CRD IV, as well as the following two specific objectives:

- ▶ enhancing adequacy of capital and liquidity requirements
- ▶ enhancing bank risk management

5. To meet the liquidity coverage requirement, institutions must hold a stock of HQLA to cover the total net cash outflows over a 30-day period. These assets should be liquid in markets

during a time of stress and, in most cases, be eligible for use in central bank operations. However, in some jurisdictions where there are not enough HQLA available, the CRR allows institutions to use derogations to meet the liquidity coverage requirement. These derogations should be in line with the Basel III framework.

Issues addressed by the technical standards

6. The CRR mandates the EBA to develop draft ITS listing the currencies with constraints on the availability of liquid assets. For all the currencies listed, the derogations to the liquidity coverage requirement set out in Article 419(2) of the CRR shall apply.

Methodology used and technical option chosen

7. The EBA has developed a methodology based on the comparison of the estimated demand and supply of liquid assets to establish in which currencies a shortfall in liquid assets may exist. The EBA has also assumed that a buffer of free-floating assets of 25% of the estimated HQLA demand would be appropriate to maintain a sufficient level of liquidity in the financial markets under analysis. The methodology assumes that institutions target a liquidity coverage requirement of 110% reflecting the fact that institutions may aim to hold liquid assets in excess of the minimum required.

8. When the estimated demand for HQLA, incorporating the buffer of free-floating assets and the excess holding of liquid assets, exceeds the estimated supply of HQLA, the derogations to the liquidity coverage requirement set out in Article 419(2) of the CRR shall apply.

Impact

Costs

9. The process of determining the eligibility of currencies is based on data available at the national supervisory authorities and will not cause additional costs for institutions.

10. The EBA has currently identified only two EU currencies for which the availability of liquid assets is less than justified demand. The number of institutions operating in these currencies is also small and the amount of total assets that they hold represents only a small share of the total assets held by the banking sector in the EEA. The risk of creating an uneven playing field for the application of the liquidity coverage requirement is therefore low.

Benefits

11. The pre-set methodology by which these ITS have been determined will ensure that currencies with a shortfall in liquid assets are identified on a consistent basis. It will also ensure that institutions operating in these currencies may use the derogations to the liquidity coverage requirement to meet their liquidity requirements, where appropriate. The methodology includes the assumption that a buffer of free-floating assets of 25% is necessary to avoid the liquidity

coverage requirement impeding the liquidity of the financial markets in which those institutions operate.

4.2 Views of the Banking Stakeholder Group (BSG)

The BSG provided several comments on the steps undertaken in calculating the liquid asset shortage for Norway. First, the BSG pointed out that public data from Norway suggests that the share of government bonds owned by foreign investors (which the BSG understands to be all locked up according to the methodology by the EBA), was close to 50% as of June 2012. This is considerably higher than the 20% used by EBA and would give rise to a much larger shortfall of liquid assets.

Second, the BSG disagrees with the classification of Norwegian covered bonds as illiquid, for the purposes of these ITS, based on the EBA's view that the trading volumes for this asset type are too low. The BSG points out that the volatility metrics of the covered bond market are better than the trading volumes, supply side liquidity has improved markedly with issuance taking place almost on a daily basis, and increased repo market activity is being further developed by the Norwegian banking sector.

Third, the BSG considered that the analysis was not sufficiently robust, given the sensitivities presented in the background section of the consultation paper (CP), and the relevance that the outcome has for the limits in the related draft RTS.

The BSG recommended that the EBA update the analysis once it has published the report on HQLA (20 December 2013), basing it on the recommendations contained therein.

Lastly, the BSG indicated that it would like to see a detailed analysis performed for currencies other than DKK and NOK.

EBA response

These points are addressed in the table of Section 4.3.

4.3 Feedback on the public consultation and on the opinion of the BSG

The EBA publicly consulted on the draft proposal contained in this paper.

The consultation period lasted two months and ended on 22 December 2013. Ten responses were received, of which seven were published on the EBA website. The BSG also provided an opinion on the draft ITS.

This paper presents a summary of the key points and other comments arising from the consultation, the analysis and discussion triggered by these comments.

In many cases, several industry bodies made similar comments or the same body repeated its comments in the response to different questions. In such cases, the comments, and EBA analysis, are included in the section of this paper that the EBA considers the most appropriate.

No changes to the draft ITS have been made as a result of the responses received during the public consultation.

Summary of key issues and the EBA's response

General comments

Respondents generally welcomed the opportunity to comment on the EBA's proposal. Overall, some respondents argued in favour of changing the methodology and assumptions to result in higher shortage numbers, and doing further analysis to see whether additional currencies would be included in the list. In contrast to this, other respondents were concerned that there may be an impact on the level playing field. Specifically, they were concerned that banks operating in countries in which a liquid asset shortage has been observed may gain an advantage compared to banks operating in other jurisdictions.

A recurring general comment was that the exercise should be repeated regularly, particularly following the delegated act.

EBA response

Regarding frequency, as already mentioned in the CP, to keep the ITS up to date, the EBA will repeat its analysis whenever a change (or series of changes) occurs that is likely to have a major impact on the outcome. Such an event may include a material change in the outstanding amount of liquid assets (e.g. government bonds), the amount of assets locked up by institutions not subject to the CRR, or the aggregate net outflows of institutions subject to the CRR. The ITS will

also be updated taking into consideration new currencies for which the data collection process has been completed. In any case, the analysis will be repeated after the final EU definition of transferable assets of extremely high and high liquidity and credit quality following the finalisation of the Commission's delegated act on liquidity coverage requirements under Article 460 of the CRR. The recalculation will be started by the EBA.

Method for estimating the level of free-floating assets

Some respondents indicated that an assumption of a free floating layer of liquid assets of 25% in excess of demand should be increased somewhat, while others advocated that it should be based on a percentage, either determined via a more advanced calibration process with more attention to certain factors, including market size, or based on the supply of liquid assets.

EBA response

In view of the need for harmonised application and the pressing timeline, which precluded an empirical assessment, the EBA has decided to keep the buffer at 25%. In the interest of avoiding undue complexity, the EBA has decided to maintain the approach of calculating the free-floating layer of liquid assets on the basis of demand for liquid assets. Respondents did not explain why 25% may be too low or too high. The level of this free-floating buffer might be revised based on empirical observations in future revisions of these ITS, once the liquidity coverage requirement is implemented as a mandatory minimum requirement.

Assumptions regarding locked-up assets

Respondents tended to argue in favour of a more sophisticated determination of locked-up assets. They said that differences between jurisdictions and collateral needs deriving from CSAs, CCPs, and supplementary assets in covered bond pools should also be taken into account. Also suggested was treating central bank deposits as locked up.

EBA response

The EBA already applies a bottom-up, fact-based, expert-driven approach to evaluate potential lock-up.

The EBA acknowledges that collateral needs deriving from central bank intraday liquidity, CSAs, CCPs and cover bond pools could also be a source of locked-up assets. On the other-hand, the EBA has no reason to assume that these needs are material, also considering that for some of them, the type of collateral could consist of less liquid assets. The posting of CSA collateral could provide a source of liquidity via rehypothecation, as collateral posted by one institution could be

used by the receiving institution. The assumption of a 25% free-floating layer of assets should also accommodate such needs.

The EBA considers that if withdrawable deposits at the central bank are part of the liquid asset buffer (in the BCBS standard) the withdrawable part should be seen as available supply.

Target liquidity coverage requirement at 110%

Most respondents agree that the liquidity coverage requirement target level should be above 100%. However some respondents find that a level of 110% is too low in some cases, due to business models, size and scope of operations, as well as challenges facing European banks in peripheral countries.

Some respondents argue that the liquidity coverage requirement target level should not be fixed as it may vary over different macro cycles. The target level should thus be re-examined over time.

EBA response

The point about business models does not support the idea that 110% would be too low system-wide for all institutions in a currency. More generally, transitional arrangements for the liquidity coverage requirement set out in Article 460 of the CRR should facilitate a gradual transition to a 100% liquidity coverage requirement. These have not been taken into account.

The EBA may review the target amount over time in relation to macro-related factors.

In response to market pressure to hold more highly liquid assets, institutions can still do so and communicate this to their stakeholders. This is regardless of the liquidity coverage requirement and these final draft ITS.

General approach and its results

Several respondents find the analysis is not sufficiently robust, pointing to dependency on assumptions and arguing that it is lacking empirical proof and transparency on input data. Their suggestion therefore is not to make the use of derogations solely dependent on the estimated shortfall.

EBA response

In articulating these points the respondents were not clear about what effects would take place and why. The results of sensitivity analyses were presented in the background section of the CP (as well as in the final draft ITS), acknowledging that the methodology is sensitive to specified inputs, which also underlines the need for frequent updating.

The EBA has pursued a high degree of transparency in the drafting of the final draft ITS. Nonetheless, the EBA cannot pursue complete transparency, given that the analysis is partly based on confidential data, such as that of the EBA's voluntary reporting exercise and/or in the BIS Quantitative Impact Study.

Cost-benefit analysis

Some respondents disagree with the statement that the risk of creating an uneven playing field for the application of liquidity coverage requirements is low. They argue that the use of the derogations on the basis of these ITS and the related RTS under Article 419(5) of the CRR, given the requirements in the RTS which specify the derogations, can rather be considered as disadvantageous instead of advantageous.

On the other hand, some respondents are concerned about creating an uneven playing field as banks operating in countries in which a liquid asset shortage has been observed may gain an advantage when compared to banks operating in other jurisdictions.

EBA response

With these ITS, and the related RTS, the EBA is fulfilling a mandate provided in the CRR. The CRR, in line with the BCBS standard, indicates the need for a list of currencies, which are those with a liquid asset shortage as a pre-existing situation that can be alleviated by means of derogations that institutions can apply under certain stringent conditions. The EBA has therefore drafted the ITS and related RTS providing further specifications in accordance with this mandate and the BCBS standard. These specifications are intended to limit the use, or ensure that there is controlled use of the derogations. Respondents do not specify how the EBA could have drafted the ITS and related RTS differently under the mandate given, and how this would have reduced what is, in their view, a propensity for the ITS and RTS to lead to a situation where banks gain an advantage or disadvantage. In addition, respondents seem divided about whether residing in a jurisdiction in which the currency has a shortage of liquid assets, is advantageous or disadvantageous.

Summary of responses to the consultation and the EBA’s analysis

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
General comments			
	<p>One recurring question in the responses was about the appropriateness of using the BCBS definition of liquid assets as a proxy for performing the analysis underlying these ITS, and about the possibility that this definition, or other input factors in the analysis could change. A common request was for frequent or continuous recalculations.</p>	<p>As mentioned in the CP, the EBA will undertake another assessment on the basis of the final EU definition of transferable assets of extremely high and high liquidity and credit quality following finalisation of the Commission’s delegated act under Article 460 of the CRR on liquidity coverage requirements. Nonetheless, given the timeframe provided by the CRR, these final draft ITS are to be based on an analysis using the BCBS definition of liquid assets as a proxy. As also mentioned in the CP, regarding changes to other input factors in the analysis, the EBA will perform timely re-assessments, especially whenever a change (or series of changes) occurs that is likely to have a major impact on the outcome. The ITS will also be updated taking into consideration new currencies for which the data collection process has been completed.</p> <p>Nonetheless, it should be also understood that the recalculation by the EBA will not be continuous, as in the view of the EBA, this would be operationally too burdensome, and would probably only marginally affect outcomes. In addition, a minimum frequency would create an undue burden if there is no reason to assume that the situation had significantly changed.</p>	<p>No amendments made</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>Some respondents indicated that an assumption of a free floating layer of liquid assets of 25% in excess of demand should be increased somewhat, while others advocated that it should be based on a percentage, either determined via a more advanced calibration process with more attention to certain factors, including market size, or based on the supply of liquid assets.</p>	<p>In view of the need for harmonised application and the pressing timeline, which precluded an empirical assessment, the EBA has decided to keep the buffer at 25%. In view of the pressing timeline, it was not possible to set up an empirical assessment. In the interests of avoiding undue complexity, the EBA has decided to keep the approach to calculating the free-floating layer of liquid assets on the basis of the demand for liquid assets. Respondents did not explain why 25% may be too low or too high.</p>	
	<p>Several respondents find the analysis is not sufficiently robust, pointing to dependency on assumptions and arguing that it is lacking empirical proof and transparency on input data.</p>	<p>The respondents were not clear about how the analysis is not sufficiently robust. The results of sensitivity analyses were presented in the background section of the CP (as well as in the final draft ITS), acknowledging that the methodology is sensitive to specified inputs, which also underlines the need for frequent updating.</p> <p>The EBA has pursued a high degree of transparency in the drafting of the final draft ITS. Nonetheless, the EBA cannot pursue complete transparency, given that the analysis is based partly on confidential data, such as that of the EBA's voluntary reporting exercise and/or in the BIS Quantitative Impact Study.</p>	<p>No amendments made</p>
Scope of analysis	<p>Several respondents are concerned about the scope of the analysis and question why only DKK and NOK have been included. They suggest that SEK and South Eastern Europe (CESEE) currencies be included. A thorough assessment for all the European Union currencies (including EUR) should be done so as to understand the relative</p>	<p>As mentioned in the CP, for the other currencies, none of the competent authorities wanted an analysis completed at the EBA level on the potential qualification of their currencies for the purpose of these final draft ITS. This reflects the EBA's view that an assessment would not be worth the operational costs for many of the currencies as they may be</p>	<p>No amendments made</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	differences between currencies better and be able to observe trends in liquid asset availability in the future. EBA is encouraged to make an additional effort and perform a thorough assessment to cover all EU currencies.	unlikely to qualify and time was limited, plus competent authorities might not be able to assess accurately whether an assessment would be worthwhile.	
BCBS definition as a proxy	Some respondents argue that it is problematic that the analysis is based on the BCBS definition, given that this may prove an imperfect proxy for the final EU definition.	The EBA will undertake another assessment on the basis of the final EU definition of transferable assets of extremely high and high liquidity and credit quality following the finalisation of the Commission's delegated act under Article 460 of the CRR on liquidity coverage requirements. However, given the timeframe provided by the CRR, these final draft ITS have to be based on an analysis using the BCBS definition of liquid assets as a proxy.	
	One respondent further seeks some analysis of what they call 'dynamic responses in the market' and some scenarios which show the demand and response from market participants. The respondent claims that these would materially affect the demand for HQLA.	The respondent is not clear about what effects would take place and why. The results of sensitivity analyses were presented in the background section of the CP (as well as in the final draft ITS), acknowledging that the methodology is sensitive to specified inputs, which also underlines the need for frequent updating.	No amendments made
	Other respondents emphasise a need for further transparency on input data, method and assumptions.	The EBA has pursued a high degree of transparency in the drafting of the final draft ITS. Nonetheless, the EBA cannot pursue complete transparency given that the analysis is partly based on confidential data, such as that of the EBA's voluntary reporting exercise and/or in the BIS Quantitative Impact Study.	
Another respondent states that it is impossible to	The EBA acknowledges that the outcome would be different, especially if deviations from the Basel definitions are implemented via the delegated act to be finalised by the Commission by 30 June 2014. The		

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>investigate which currencies will face a lack of HQLA when there is no final EU definition of HQLA. Another respondent argues that in the event that covered bonds were added to the highest level of liquid assets when the Commission decides on the final definition of the liquidity coverage requirement in June 2014, Denmark would no longer be classified as a country with insufficient liquid assets.</p>	<p>reason for basing the final draft ITS on the Basel definition is that there is no other internationally consistent definition available at present. Given the CRR deadline to finalise the standard, there was no other option other than to base it on this definition.</p>	
<p>Identification of non EEA currencies</p>	<p>One respondent comments on the identification of constraints on liquid assets in non-EEA currencies and agrees on, what the respondent sees as, leaving it to the local regulators. However, it is argued that it creates uncertainties for European banks since the CRR liquidity coverage requirement may be binding on them before these analyses are completed. Further the EBA is requested to clarify the treatment for the jurisdictions where the Basel III LCR is not implemented.</p>	<p>As indicated in the CP, the EBA considers it preferable to consider non-EEA currencies in the light of the assessments of constraints on the availability of liquid assets as performed by the relevant non-EEA jurisdiction itself. Note in this regard, that the EBA, and its members, does not have the relevant data at their disposal for these currencies. For similar reasons, it would be difficult to assess the non-EEA jurisdictions where the Basel III liquidity coverage ratio will not be implemented, with the added difficulty that an absence of a liquidity requirement could theoretically mean that demand by bank (or bank-like entities) is close to zero.</p>	<p>No amendments made</p>
<p>Covered bonds classification</p>	<p>Several respondents comment on the classification of covered bonds as illiquid in Norway. One argues that this should not be taken on a stand-alone basis but there should be an assessment of covered bonds across Europe.</p> <p>Another respondent requests that a broader assessment be undertaken. An in-depth analysis of the Norwegian covered bond market should be</p>	<p>The delegated act of the Commission will be adopted by 30 June 2014 so the final EU liquidity coverage requirement liquid asset buffer definition is not yet made. Therefore, there is no alternative to basing these final draft ITS on the BCBS buffer definition. EBA cannot pre-empt the delegated act by the Commission.</p>	<p>No amendments made</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>made, taking more factors/variables into account, including the fact that the market has been through a build-up phase.</p> <p>Other respondents emphasise the importance of allowing assets with high credit quality and good liquidity to be recognised as extremely high quality liquid assets. Swedish, Norwegian and Danish covered bonds are emphasised here due to the very liquid domestic markets for these assets.</p> <p>One respondent emphasises that the Danish government bond market is small in the international comparison and requiring institutions to hold a large proportion of the government bonds in circulation in a liquidity buffer would negatively affect the liquidity of these bonds, especially given the estimates of a high number of buy-and-hold investors in the market. Monetary and financial institutions have historically been minor holders of Danish government debt.</p>	<p>The classification of covered bonds as illiquid in Norway follows from a point-in-time application of the BCBS definition. Determining the composition of the liquidity coverage requirement definition of assets of extremely high liquidity and credit quality is not the objective of these ITS.</p> <p>This is why there is a 25% free floating buffer assumption.</p>	
Frequency of recalculation	<p>One respondent emphasises that it is not clear with what frequency the calculation will be repeated, or who can make the request for recalculation.</p>	<p>Regarding frequency, as already mentioned in the CP, to keep the ITS up to date, the EBA will repeat its analysis whenever a change (or series of changes) occurs that is likely to have a major impact on the outcome. Such an event may include a material change in the outstanding amount of liquid assets (e.g. government bonds), the amount of assets locked up by institutions not subject to the CRR, or the aggregate net outflows of institutions subject to the CRR. The ITS will also be updated taking into consideration new currencies for which the data collection process has been completed. In any case,</p>	No amendments made

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>One respondent emphasised the importance of continuous recalculation because of changes in both the total amount of liquid assets, changes in the holdings of locked-up assets and revised assumptions about the necessary amount of free-floating liquid assets. Another suggestion is to repeat the calculation with a minimum frequency.</p> <p>It is further emphasised that banks should have some time to adjust – especially when reducing an estimated shortfall and thus having a reduced need for derogations. One respondent suggests a gradual scaling down or a time frame for adjustment before reducing usage of derogations.</p> <p>Another respondent urges EBA to update its analysis as soon as its own recommendations on the applicable caps that apply to inflows, and to different liquid asset categories within the liquidity coverage requirement are known and it can embed these into its analysis.</p> <p>One respondent noted that at the public hearing of this CP on 19 November 2013 the EBA stated that</p>	<p>the analysis will be repeated after the final EU definition of transferable assets of extremely high and high liquidity and credit quality following the finalisation of the Commission’s delegated act on liquidity coverage requirements under Article 460 of the CRR. The recalculation will be started by the EBA, in coordination with its members.</p> <p>The suggestion of continuous recalculation, which the EBA understands as meaning as soon as data availability (reporting frequencies, etc.) allowed, would, in the view of the EBA, be operationally too burdensome, and would probably only marginally affect outcomes. In addition, a minimum frequency would create an undue burden if there is no reason to assume that the situation had significantly changed.</p> <p>There is a 25% free floating buffer assumption for this reason. In addition, any of these gradual approaches would unduly complicate the framework.</p> <p>The EBA cannot pre-empt the delegated act on liquidity coverage requirements by the Commission in the drafting of these ITS. In any case, this would be challenging in terms of deadlines.</p> <p>The EBA did not state that it would be up to the competent authorities (alone). It would be for the EBA to decide on a review, with a greater role for the</p>	

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	it would be up to the national authorities themselves to assess the need for recalculation.	relevant competent authority to signal the need for changes.	
Responses to questions in Consultation Paper EBA/CP/2013/38			
<p>Question 1.</p> <p>Do you agree with the method for estimating the level of free-floating assets required for a market to remain liquid? If not what alternative methodology would you suggest and what percentage would you deem to be appropriate? Please substantiate your response.</p>	<p>Several respondents find it necessary to have a large level of free-floating assets to maintain liquid markets – especially for the smaller ones.</p> <p>Some respondents agree with the methodology for setting the level of free-floating assets but several respondents question the approach. Two respondents argue that setting the level at 25% is an undesirable simplification and more flexibility is appropriate, at least taking market size into consideration.</p> <p>It is further suggested by several respondents that the free-float level should be based on an empirical assessment of the buffer level of all the different markets and submarkets. One respondent also emphasised that the factors for calculating the free-float level are volatile and should therefore be taken into account. An example given is the interest rate which affects the market value of government bonds and thereby the size of the free-float buffer.</p> <p>One respondent suggests that as an alternative to empirical calculations the free-float level should be set very high (e.g. above 50%) to ensure that markets remain liquid.</p> <p>One respondent questions whether it is possible to set one free-float level which would always be</p>	<p>This reflects the view as expressed by the EBA in the CP that a 25% buffer meets these needs.</p> <p>In view of the need for harmonised application and the pressing timeline, which precluded an empirical assessment, the EBA has decided to keep the buffer at 25%.</p> <p>In view of the limited timeline for the finalisation of these ITS under CRR, it is not possible to set up an empirical assessment. Regarding potential volatility in the need for a layer of free-floating assets, the results of the EBA’s approach should not lead to large fluctuations in the results over time.</p> <p>Respondents did not explain why 25% may be too low or too high.</p> <p>In the interest of avoiding undue complexity, the EBA has decided to keep the approach of calculating the free-floating layer on the basis of demand.</p>	No amendments made

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>right for any market and further argues that the free-float level should not depend on demand as long as the market is not defined but rather on supply in submarkets.</p>		
<p>Question 2. Are the assumptions regarding locked-up assets reasonable and if not what alternative assumptions should be made? Please substantiate your response?</p>	<p>Most respondents agree with the overall assumptions for this analysis. However, many of them argue that this kind of analysis is more nuanced than that described in the CP, with one respondent arguing that the assessment of locked-up assets should be more sophisticated, reflecting amongst others things, differences between jurisdictions (markets) and currency areas.</p> <p>One respondent finds it unclear whether all assets owned by foreign investors are considered as locked up.</p> <p>The same respondent further argues that collateral held with the central bank for intraday liquidity, collateral posted under CSAs, CCPs, and supplementary assets in cover bond pools could also be sources of locked-up assets.</p>	<p>The EBA already applies a bottom-up, fact-based, expert-driven approach to evaluate potential lock-up.</p> <p>Regarding collateral held by foreign investors, assets held by all non-CRR-regulated investors have been considered in these analyses as locked up, also if they are foreign assets. Demand by CRR-regulated foreign investors has not been considered as locked up.</p> <p>The EBA acknowledges that collateral needs may have an intraday character, and that CSAs, CCPs and cover bond pools could also be a source of locked-up assets. On the other hand, the EBA has no reason to assume that these needs are material, also since for some of them, the type of collateral could consist of less liquid assets. The posting of CSA collateral may provide a source of liquidity via rehypothecation, as collateral posted by one institution could be used by the receiving institution. The assumption of a 25% free-floating layer of assets should also accommodate such needs.</p> <p>This seems to call into question whether certain long-term assets should be considered liquid rather than addressing the potential locked-up amount. As</p>	<p>No amendments made</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>One respondent noted that the majority of Danish government bonds outstanding are long-term bonds, not well suited as liquidity risk management instruments, and therefore suggests that the amount of long-term bonds should be considered an additional type of locked-up assets.</p> <p>Other respondents argue that the assumption of one fifth of Norwegian government debt being locked up is not in accordance with official data (Norwegian Ministry of Finance) and in fact 50% of government debt is held by foreign investors.</p> <p>One respondent comments on the statement that nearly 20% of the Danish government debt is held by foreign central banks, and argues that the total holdings of Danish government debt by foreign investors are roughly twice as much and highly inaccessible from a domestic perspective. Additionally, some domestic collective investment funds and government funds investing in Danish government debt are also to a large extent considered buy-and-hold investors – in total roughly up to 20%.</p>	<p>mentioned previously, the EBA is using the existing international definition of liquid assets (i.e. the BCBS definition).</p> <p>The observation is that the amount of government debt outstanding was NOK 477 bn, of which approximately 45% was locked up by foreign investors. Based on experience with domestic investors, indicating that roughly 50% are non-CRR-regulated institutions, the 45% is divided in two, resulting in a figure of 22.5% which has been applied.</p> <p>Danish securities statistics indicate that in September 2012 foreign investors held approximately 38% of the outstanding debt. This demand stems both from foreign central banks and other investors, possibly CRR-regulated institutions. The data does not allow for a sector breakdown of the holdings. In this calculation, the central banks are assumed to make up half the foreign holdings of government bonds, hence the 20%.</p> <p>Regarding government funds investing in Danish government bonds, in September 2012, the share held was 10% of the outstanding, amounting to roughly DKK 85 bn. These assets have also been considered in the analysis as locked up. Regarding collective investment funds, no relevant data was available to the EBA. In addition, institutions can invest in collective investment undertakings, counting them as highly liquid assets to some extent,</p>	

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>One respondent points out that the analysis does not take into account (i) the QIS results published by the EBA, which show that 46% of liquid assets of European banks are held in the form of deposits at Central Banks, (ii) the credit limits that banks have to adopt for their investment portfolio that constitute actual operational limits to the liquid assets they could actually use (and the market would accept).</p> <p>One respondent noted that at the public hearing of this CP on 19 November 2013 the EBA stressed that they would - in the short term - leave the assessment of locked-up assets up to the national authorities.</p>	<p>which implies that government bonds bought by these undertakings are not necessarily locked up.</p> <p>Leaving aside where this number was derived from, the EBA considers that if withdrawable deposits at the central bank are part of the liquid asset buffer (in the BCBS standard) the withdrawable part should be seen as available supply. Moreover, this figure is derived from average data of institutions subject to the EBA QIS voluntary exercises, and therefore does not represent a reliable proxy for a given Member State or currency. Regarding limits to buffer type concentrations, this is potentially a wider issue and therefore not specifically relevant for these ITS.</p> <p>The EBA did not state that it would be up to the competent authorities (alone). The EBA depends on the national authorities to collect data, after which an EBA-wide panel of experts will give its views on the degree of lock-up.</p>	
<p>Question 3. Is 110% a reasonable assumption for an institution's target liquidity coverage</p>	<p>Most respondents agree that the liquidity coverage requirement target level should be above 100%. However some respondents find that a level of 110% is too low in some cases, due to business</p>	<p>The point about business models does not support the idea that 110% would be too low system-wide. More generally, transitional arrangements for the liquidity coverage requirement set out in Article 460</p>	<p>No amendments made</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
<p>requirement? If not please outline what you deem to be a reasonable assumption regarding an institution's target liquidity coverage requirement. Please substantiate your response.</p>	<p>models, size and scope of operations as well as the current situation for European banks (the crisis in southern Europe).</p> <p>One respondent suggests that EBA conduct a study about which liquidity coverage requirement levels would please investors in order to establish a more reliable target.</p> <p>Some respondents argue that the liquidity coverage requirement target level should not be fixed as it may vary over different macro cycles. The target level should thus be re-examined over time.</p>	<p>of the CRR should facilitate a gradual transition to a 100% liquidity coverage requirement. These have not been taken into account.</p> <p>The EBA considers that given that the liquidity coverage requirement is not fully calibrated, such a study would not be possible.</p> <p>The EBA may review the target amount over time in relation to macro-related factors.</p> <p>Institutions might respond to market pressure in a way which does not involve picking a higher liquidity coverage requirement target. For example, they could hold additional assets with high liquidity characteristics.</p>	
<p>Question 4.</p> <p>Do you agree with the general approach and its results?</p>	<p>Several respondents find the analysis is not sufficiently robust, while pointing to dependency on assumptions and arguing that empirical proof and transparency on input data is lacking. Their suggestion therefore is to not make the use of derogations solely dependent on the estimated shortfall.</p>	<p>The respondents were not clear about what effects would take place and why. The results of sensitivity analyses were presented in the background section of the CP (as well as in the final draft ITS), acknowledging that the methodology is sensitive to specified inputs, which also underlines the need for frequent updating.</p> <p>The EBA has pursued a high degree of transparency in the drafting of the final draft ITS. Nonetheless, the EBA cannot pursue complete transparency given that the analysis is partly based on confidential data, such as that of the EBA's voluntary reporting exercise and/or in the BIS Quantitative Impact Study.</p> <p>The demand for liquid assets from the branches of those foreign credit institutions, residing within the relevant country, but not captured in the data, is estimated by scaling the estimate for the (domestic)</p>	<p>No amendments made</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>One respondent questions whether the assessment of demand for liquid assets includes demand from (i) institutions inside EEA that need HQLA for their liquidity coverage requirement but who are not overseen by the local competent authority that has reported the information; and (ii) institutions outside EEA that need HQLA for their liquidity coverage requirement in some EU currency.</p>	<p>institutions that have been captured in the data, with the relationship between total assets of uncaptured credit institutions and total assets of credit institutions. For the two currencies that have been listed in these ITS, it is assumed that the demand from foreign CRR-regulated, or Basel III-compliant, institutions, as far as not captured by the above-mentioned scaling, is less material. This scaling may overestimate the demand for the currency in question, as branches may be more prone to have a demand in a foreign currency.</p>	
	<p>One respondent argues that the amount of NOK government debt was temporarily high in the period 2009-2014 due to a swap arrangement set up by the Norwegian Government and that the amount will be reduced in the future, thus increasing the shortage of NOK liquid assets. The respondent further argues that including</p>	<p>Regarding government issuance of debt, the EBA does not wish to overcomplicate its assessment and speculate on whether certain arrangements may be increased, decreased or continued by sovereigns. Regarding preferences of institutions to hold asset types other than equity, this is potentially a wider issue and therefore not specifically relevant for these ITS. In addition, it cannot be excluded that in the future, more holdings of equities by institutions may be made.</p> <p>Regarding buffer type concentrations and the treatment of unrealised gains and losses, this is potentially a wider issue and therefore not specifically relevant for these ITS.</p>	

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>Norwegian equities as liquid assets overestimates the availability of liquid assets as Norwegian banks have no tradition of holding these assets on their balance sheet.</p> <p>One respondent points out that the analysis does not take into account (i) The concentration risk in government debt (even though disentangling the banking industry from the sovereign risk is an intended objective of the regulations); and (ii) the impact of unrealised gains and losses of their available-for-sale securities that are no longer filtered out of prudential capital, which creates a disincentive to invest in securities, even more so in long-term securities.</p>		
<p>Question 5.</p> <p>Do you agree with the above analysis of the cost and benefit impact of the proposals?</p>	<p>Some respondents disagree with point 10 in the cost-benefit analysis which states that the risk of creating an uneven playing field for the application of liquidity coverage requirement is low. They argue that the use of the derogations on the basis of these ITS and the related RTS under Article 419(5) of the CRR, given the requirements in the RTS which specify the derogations, can rather be considered as disadvantageous instead of advantageous.</p> <p>Some other respondents are concerned about creating an uneven playing field as banks operating in countries in which a liquid assets shortage has been observed may gain advantage compared to banks operating in other jurisdictions.</p>	<p>With these ITS, and the related RTS, the EBA is fulfilling a mandate provided in the CRR. The CRR, in line with the BCBS standard, indicates the need for a list of currencies, which are those with a liquid asset shortage as a pre-existing situation that can be alleviated by means of derogations that institutions can apply under certain stringent conditions. The EBA has therefore drafted the ITS and related RTS providing further specifications in accordance with this mandate and the BCBS standard. These specifications are intended to limit the use, or ensure that there is controlled use of the derogations. Respondents do not specify how the EBA could have drafted the ITS and related RTS differently under the mandate given, and how this would have reduced what is, in their view, a propensity for the ITS and RTS to lead to a situation of banks gaining advantage or disadvantage. In</p>	<p>No amendments made</p>

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addition, respondents seem divided about whether residing in a jurisdiction of which the currency has a shortage of liquid assets, is advantageous or disadvantageous.
