December 2009

Feedback to the public consultation on

"Consultation Paper on Liquidity Buffers & Survival Periods" (CP28)

1. In July 2009, CEBS published a consultation paper (CP28) on liquidity buffers and survival periods. The consultation period ended 31 October 2009. CEBS also discussed the proposed guidelines with market participants in a public hearing held on 22 September 2009. 11 responses were received. One respondent preferred the comments to be kept commercially confidential, while the other 10 comments are published on the CEBS's website.

2. This paper presents a summary of the major points arising from the consultation and the changes made to address them. It includes a section presenting CEBS's views on the public comments.

3. In assessing the comments, CEBS distinguished between:

   - General comments on issues relating to the basic concepts and overall content of the consultation paper
   - Responses to specific guidelines
   - Responses to specific questions posed in the consultation paper.

4. In many cases, several institutions made similar comments, or the same body repeated its comments in its response to different questions. In such cases, the comments, and CEBS's analysis of them are included in the section of the detailed part of this paper where CEBS considers them most appropriate.

5. The responses were generally positive and supportive of CEBS's work. Some more explanatory text and a few minor changes have been made to the guidelines.

General remarks

6. In general the respondents supported the risk-based and principle-based character of the CEBS guidelines, taking into account the wide variety of business models and types of liquidity risk management in the banking industry. The comments acknowledged that a principle-based approach requires dialogue and interaction between the supervisors and the institutions. This, in turn, should give the supervisors a detailed and comprehensive understanding of the institutions activities and risk level.

7. The respondents appreciated CEBS's commitment to proportionality as an overarching principle.

8. Several comments suggested that CEBS, in addition to a general assessment of the impact on banks and national economics, should undertake an impact study before the guidelines enter into force to assess effects on securities markets.

Specific remarks

9. Respondents commented on aspects regarding types of stress tests and stress test assumptions, such as f. example definition of wholesale funding and the stability of different types of wholesale funding in a stress situation.

10. Respondents commented that institutions need longer stress test periods than mentioned in these guidelines since liquidity risk planning is extended much further in time. For the short end of the liquidity planning covered by these guidelines, some respondents were in favour of only one survival period of one month, while others supported the guidelines' recommendations for two survival periods, of one week and one month.

11. The majority of the respondents took the view that a too narrow definition of the assets eligible for the liquidity buffer should be avoided. In their view, central bank eligibility of an asset should be the decisive and single criterion.

12. The respondents agreed with the tone of the consultative paper that central banks should not be seen as a primary provider of liquidity and agreed with this point of view. It was emphasized, however, in several comments that there is a strong correlation between the liquidity of assets and the overall market conditions. Assets that are highly liquid under normal conditions can become illiquid in periods of stress. Therefore, the central bank will always have an important role to play in terms of providing liquidity to banks in periods of name-specific or general economic stress.

13. Several comments raised the question of objective criteria establishing that assets are highly liquid in private markets.

14. Respondents agreed with CEBS that a sufficient diversification of the assets in the liquidity buffers is important for marketability, but mentioned that it may be hard for some firms to avoid holding large concentrations of particular assets if the definition of eligible assets is too narrow.

15. Concerns were raised in some comments relating to international cross border banks and any limitations which may impair the free flow of liquidity within a group. Respondents asked for coordination of regulators and supervisors in the direction of harmonisation of practices and to contribute to a more efficient treatment of cross border firms, and finally improve communication amongst supervisory colleges.

CEBS's responses to the comments received

16. CEBS's guidelines are principle-based guidance to institutions and not regulatory requirements. The guidelines give no prescriptions as to quantitative parameters to be used. A thorough quantitative impact assessment can, therefore, not be done. During the consultation period CEBS has, however, analysed more thoroughly the economic impact of liquidity buffers in general. For conclusions from this analysis, see the introductory section of the guidelines.

17. CEBS will incorporate some more explanations in the introduction to the guidelines to clarify the purpose of the short term liquidity buffers and their place and relationship to the liquidity risk management of the firm in broader terms, including among others, funding ratios and limits for maturity gaps and stress test limits for shorter and longer periods and contingency planning.

18. The guidelines give examples of assumptions which can be used in the calculations of outflows of funding in stress conditions. Some more explanations relating to specific comments are given in the text.The severity of the stress test assumptions should, however, be carefully examined and decided by the institutions themselves, according to its liquidity risk strategy and based upon empirical statistics of behaviours and the volatility of different types of assets and liabilities under stress conditions.

19. For the short term survival period (one week and one month) it is of the outmost importance that the institutions have a buffer consisting of assets that are reliably liquid under stress conditions, including a market -specific stress. Banks' liquidity management should, primarily, be based on being self-sufficient, using the different funding sources in the deposits, capital and money markets. Central banks should not be seen as a primary provider of liquidity. On the other hand, it should be recognized that banks should be able to generate liquidity from normal central bank operations/facilities. Based on these considerations guideline 4 about the composition of the liquidity buffers will be kept unchanged.

20. CEBS has, during the consultation period, elaborated some more on the criteria for a reliably liquid asset. More guidance on this topic is given in Annex 2.

21. These guidelines are meant to be guidance for institutions - national liquidity regulations are outside the scope of this paper. In June 2009, CEBS published a paper on a liquidity Identity Card aimed at providing supervisors of European cross-border groups with a single prudential language in order to enable meaningful exchanges of information in going-concern situations, in particular within colleges of supervisors.

Analysis of responses to CP28

Guidelines on Liquidity Buffers

Draft Text CP28	Received Comments	CEBS's Analysis	New text (proposal)
	General remarks		
Principle-based approach	In general, the respondents support the principle-based character of the CEBS's guidelines, taking into account the wide variety of business models and types of liquidity risk management in the banking industry. The comments acknowledge that a principle-based approach requires dialogue and interaction between the supervisors and the institutions. This, in turn, should give the supervisors a detailed and comprehensive understanding of the institutions' activities and risk level.	CEBS's guidelines are principle-based guidance for institutions and not regulatory requirements.	N/R
Impact assessment	Several comments suggest that CEBS, in addition to a general assessment of the impact on banks and national economics, should undertake an impact study before the guidelines enter into force to assess effects on securities markets. Before fixing a more narrow definition of the liquidity buffer, it has been suggested that an analysis of the vertical and horizontal scope of the relevant markets be performed. There are expectations about impact assessments taking into account the interactions of all the regulatory and accounting changes now being rolled out in Europe.	During the consultation period, CEBS has analysed more thoroughly the economic impact of liquidity buffers. See the introduction to the Guidelines	New text in the introduction to the guidelines, para 20 - 25
Proportionality	The comments appreciate CEBS's commitment to proportionality as an overarching principle (paragraphs 13, 33 and 34). This aspect was seen as important both for smaller banks with a conservative business policy and low risk appetite, as well as for banks that belongs to financial networks at a national level.		N/R
Risk-based approach	Several comments support the CEBS's risk-based approach regarding liquidity risk management		N/R
	Guideline 1 (Purpose of the liquidity buffer)		

Draft Text CP28	Received Comments	CEBS's Analysis	New text (proposal)
	Guideline 2 (types of stress tests)		
Paragraph 37 (new para 43) Stress-test assumptions and calibration of the buffer	Some comments contain the view that the requested combination of idiosyncratic and market-wide stress scenarios should not be understood as a simple addition of both scenario types as there are many interactions.	CEBS agrees with this.	New text in para 37 (new para 43) after "Three fundamental…." The combination of the two should not be an automatic addition as there could be many interactions to take into consideration. The three types of stress tests…
	One respondent suggests that the CEBS's approach should be complemented also with a more quantitative approach that would draw on the lessons learned from the liquidity problems experienced in the past two years, as well as relevant empirical data.	The CEBS guidelines are principle-based and choose not to prescribe quantitative parameters to be used.	N/R
	One respondent is of the opinion that from the perspective of the proportionality principle, it should be made clear that only institutions that refinance themselves in the capital market should be expected to apply market-specific scenarios.	CEBS does not agree with this comment. Institutions that are not actively financing themselves in the capital markets could be influenced indirectly by stress market conditions.	N/R
	One comment focuses on the survival period stipulated by CEBS of one month, and notes that it would be inappropriate to request a "compressing" of the impact of the financial market crisis (which by now has lasted for two years) into a one month window of time when defining the parameters of the stress scenarios. A clarification was requested.	The severity of the stress test assumptions should be carefully examined and decided upon by the institutions, according to their liquidity risk strategy and based upon empirical statistics of behaviours and the volatility of different types of assets and liabilities under stress conditions. CEBS's view is that buffers should allow banks to withstand the short and acute stress scenario or the first stages of a possible longer period of stress. This does not preclude the necessity to examine long-lasting stress scenarios and to delineate a full set of measures to tackle these scenarios.	N/R

Draft Text CP28	Received Comments	CEBS's Analysis	New text (proposal)
Para **38 (new para 44)** Idiosyncratic stress scenario and stress test assumptions	Several comments raise doubts about CEBS' view that it is plausible to assume that there will be no rollover of any unsecured wholesale funding during an idiosyncratic stress event. This view was seen as too conservative and that it lacked any empirical evidence even at the peak of the crisis.	The "no rollover" assumption mentioned in para 38 (new para 44) was meant as an example of the kind of severe but plausible assumptions that have been observed in a number of cases during the recent crisis.	N/R
	Suggestions were made that institutions should be given the possibility to use other assumptions regarding the rollover in phases of stress, in particular, for credit lines of wholesale customers with which the institution has a strong customer relationship. It is suggested that, to the extent to which a percentage of loss of wholesale funding capacity is assumed in calculating a firm's buffer, that this should be determined in discussions between the supervisor and the bank, having given consideration to each firm's internal and external environment and its respective expected capabilities and capacities.	See above	
	One respondent refers to the public hearing where CEBS expressed the view that the "no rollover" assumption was merely meant as an example of the kind of severe but plausible assumptions banks might make for stress-testing purposes. While this assumption might sometimes be appropriate, this may not always be the case. CEBS was asked to clarify the intent of giving an example rather than setting an expectation.	See above	

Draft Text CP28	Received Comments	CEBS's Analysis	New text (proposal)
	With regard to paragraph 38, one respondent comments that a multi-notch downgrade mentioned by CEBS could have an effect on an institution in terms of additional margin calls, etc. It was commented that experience has shown that single name headlines, or a sudden loss of market confidence in an institution - for instance - has a more direct effect.	CEBS agrees with this comment.	Add last sentence to para 38 (new para 44): "Experience has also shown that single name headlines or a sudden loss of market confidence in an institution - for instance – can have a severe direct effect on the institution's funding situation."
Para 39 (new para 45) Market wide stress test and stress test assumptions	Comments are made about welcoming CEBS's intention to redefine the concept of wholesale funding, as was mentioned during the public hearing. It was suggested to differentiate between banks, large corporates and small and medium-sized enterprises with regard to the speed of reaction (declining) to a market-wide stress. The assumption that retail deposits (however defined) are the most "sticky" may obscure the fact that certain classes of small and medium enterprises (SME) and corporate and institutional wholesale deposits, may, in fact, be highly stable 'relationship deposits' for a number of business reasons, whereas some forms of retail deposits (for example, brokered and "teaser-rate" deposits) may be less stable." One comment states that lack of a more nuanced definition of what qualifies as "wholesale funding" under this scenario would force banks to be overly reliant on retail deposits, which could increase competition for such deposits and thus make them less stable and "sticky" as firms compete for funding.	CEBS agrees that the concept of "wholesale" funding should be elaborated upon further.	New sentence at the end of para 37 (new para 43) "In these three types of stress scenarios, wholesale funding should be divided into financial corporates, large non-financial corporates, small and medium-sized enterprises (SME) including companies in a single person name. The speed of reaction of the depositors depends on the strength of their relationships with the institution.
	One comment sees it as important that supervisory authorities develop a uniform understanding with regard to the appropriate composition of stress scenarios. Otherwise, there would be a risk of competitive distortions. Ensuring a uniform understanding of the underlying concept of market shocks would appear particularly helpful for market-wide stress scenarios (paragraph 39).	CEBS sees the argument when it comes to assumptions for a market specific stress test. On the other hand, one should see that these guidelines are principle-based, taking into account the wide variety of business models and types of liquidity risk management in the banking industry.	N/R
	Guideline 3 (Survival periods)		
Para 43 – 48 (new para 49 - 53) Time horizons and survival periods	The comments show divergence when it comes to the need for the institutions to consider one or two survival periods, i.e. one week and one month. Some respondents were of the opinion that two survival periods would only lead to an unnecessary additional burden for the institutions and pleaded for the guidelines to apply a	To avoid a possible misunderstanding, para 44 is deleted	Para 44 in the document is deleted

Draft Text CP28	Received Comments	CEBS's Analysis	New text (proposal)
	one month survival period only. The institutions should, however, determine their liquidity buffers in a way that would allow them to withstand both, a moderate longer stress as well as acute short-term stress within a month. One respondent advocated a minimum survival period of three months.		
	Other respondents consider it appropriate to have two phases as proposed in the guidelines (one week and one month) survival period and a corresponding two-tiered definition of eligible assets, with only cash and cash-near assets qualifying for the shorter end of the survival period and a broader set of liquid assets allowed for the longer end. The alternative choice of defining a single-tiered (one month) survival period and restricting the composition of the buffer to only cash and cash-near assets (mostly, governments bonds) would distort the bond markets and entail higher costs for banks, as well as potentially negatively affecting their lending.	See above	
	One comment expresses the view that longer survival periods than than one month should not be defined for the purposes of these guid even banks' liquidity risk planning needs to extend much further that these horizons to assure banks' adaptation to circumstances and survival as going concerns. Following the logic and reasoning of CEBS's paper, the proposed periods are appropriate to capture the short-term resilience goals of buffers. Mandatory longer periods would have additional cost and economic-impact implications that would need to be taken into account.	CEBS will incorporate some more explanations in the guidelines to clarify the purpose of the short term liquidity buffers and their place and relationship to the liquidity risk management of the firm in broader terms, including stress test limits for longer periods, funding ratios and limits for maturity gaps	New text para 1 and new text above point 23 (new para 28): "Liquidity risk management in banks makes use of a broad range of measures, including, among others, funding ratios and limits for maturity gaps, stress test-based buffers and refinancing limits for shorter and longer periods and contingency planning. These guidelines are focused on liquidity buffers at the short end of the counterbalancing capacity only."
	Comments refer to the public hearing and express the view that the term "survival period" is somewhat misleading: it does not imply that a bank would plan only to survive for those periods, but that it would maintain buffers as "insurance" for such periods to assure its ability to cope with a crisis while taking other measures in line with its overall liquidity policies and risk appetite for longer-term survival. It was requested that this point be clarified in the final guidance paper.	CEBS agrees with this comment	A foot note will be appended to the last sentence in para 4 "It needs to be…": "The term "survival period" does not imply that a bank would plan only to survive for those periods, but that it would maintain buffers as "insurance" for such periods to assure its ability to cope with a crisis while taking other measures in line with its overall liquidity policies and risk appetite for longer-term survival."

Draft Text CP28	Received Comments	CEBS's Analysis	New text (proposal)
	Guideline 4 (Composition of the buffer)		
Para 49 – 60 (new para 54 – 65) The composition of the buffer – general comments	The majority of the respondents take the view that a too narrow definition of the assets eligible for the liquidity buffer should be avoided. Their view is that the central bank eligibility of an asset should be the decisive and based on a single criterion. Requiring that the assets composing the liquidity buffer be additionally "highly liquid in private markets" is viewed as not being appropriate. This will result in at least parts of the refinancing capacity of banks not being able to count for the purposes of the liquidity buffer. This would lead to a distorted reflection of the liquidity position of an institution. Another opinion is that restricting the composition of the buffer only to cash and cash-near assets (mostly, governments bonds) would distort the bond markets and entail higher costs for banks, as well as potentially negatively affect their lending. One respondent did not feel that central bank eligibility should necessarily be a requirement of the core liquidity buffer in GL 4: one reason being that we do not know what the new framework of liquidity facilities provided by central banks in the new "normal "conditions will be. There was also pointed to problems related to a bank f. example holding US Treasuries in the buffer related to its US balance sheet, even if US Treasuries are not eligible by the banks national authorities.	For the short term survival period (one week and one month) it is of the outmost importance that the institutions have a buffer consisting of assets that are reliably liquid under stress conditions, including a market specific stress. Banks' liquidity management should primarily be based on being self-sufficient using the different funding sources in the deposits, capital and money markets. Central banks should not be seen as a primary provider of liquidity. On the other hand, it should be remembered that banks should also be able to generate liquidity from normal central bank operations/facilities. Based on these considerations the guideline 4 will remain unchanged. We agree that restricting the composition of the buffer only to cash and cash-near assets (mostly, governments bonds) could create changes in bond markets and entail higher opportunity costs for banks in normal times.	N/R
	Respondent agree with the tone of the consultative paper that central banks should not be seen as a primary provider of liquidity and agree with this point of view. It was emphasized however that there is a strong correlation between the liquidity of assets and the overall market conditions. Assets that are highly liquid under normal conditions can become illiquid in periods of stress. Therefore, the central bank will always have an important role to play in terms of providing liquidity to banks in periods of name-specific or general economic stress. In such cases, central bank eligibility is viewed as being a more predictable measure of liquidity risk management and eligible for liquidity buffers than	See above. Bank should not rely too heavily on central bank eligibility of assets as a measure of their liquidity for the purposes of liquidity risk management	N/R

Draft Text CP28	Received Comments	CEBS's Analysis	New text (proposal)
	market liquidity.		
	One respondent asks for clarity as to what facilities from central banks are permanent and what are not, before an evaluation of eligible securities suitable for supporting the liquidity needs of firms can be made.	Outside the scope of this paper	N/R
	Some comments focus on smaller institutions which will often use bank paper, especially at the longer terms. Allowance for this should be made in order to recognize what is in fact prudent risk management on their part but also, and perhaps more importantly, because of the impacts that eligibility or non-eligibility of such paper will have on the large banks' funding, and, hence, on the liquidity structure of the entire market.	If smaller institutions use commercial paper issued by other banks as part of their liquidity management, such assets have to be considered in relation to the characteristics of a highly liquid asset which should be used for buffer purposes. Smaller banks which are not very active in capital markets will need to assess the liquidity of their assets accordingly.	N/R
Para 57 **(new para 62)** Assets for the longer end of the liquidity buffer	It is noted that the proposed guidelines do not explicitly state whether central bank eligible assets may be part of the longer end of the liquidity buffer, even if they are not marketable (as may be the case for bank loans or, under systemic stress, asset-backed securities). In this respect, respondents believe that a portion of the buffer *should* be allowed to be made up of such assets, provided that - given the framework of the central bank operations/facilities - a bank can reasonably assume to be able to generate liquidity from them and provided that the bank's buffer remains adequately diversified.	The guidelines para 57 (new para 62) says: "For less intense, but longer duration stress events (at least one month), banks may hold a wider set of liquid assets subject to the bank demonstrating the ability to generate liquidity from them under stress[1] within the specified period of time." To make this even more clear the first sentence of para 57 (new para 62) has been changed.	Change in the first sentence in para 57 (new para 62) "For the longer horizon, at least one month,"
Para 58 **(new para 63)** Definition of highly liquid marketable assets	Several comments raise the question of objective criteria establishing that assets are highly liquid in private markets. This is seen as a particularly relevant question considering that central bank eligibility is already substantially linked to marketability criteria, including market liquidity.	CEBS has, during the consultation period elaborated at greater length on the criteria for a reliablly liquid asset. More guidance on this topic is given in the guidelines	New text in Annex 2

[1] "under stress" means not only stressed liquidity but also stress on the value of these assets (especially in the case of market and combined stress, since the value of such assets is more likely to be negatively affected).

Draft Text CP28	Received Comments	CEBS's Analysis	New text (proposal)
	Key concepts such as - liquidity, central bank eligibility, marketability and guidelines as to which instruments will be allowed to be part of the liquidity buffer - should be defined and explained in more detail to avoid misinterpretations.		
	One respondent sees it as beneficial if guidance from regulators could be received regarding the eligibility criteria and the associated (minimum) requirements for collateral. Alignment in the European domain would be welcomed.	The topic of alignment in the EU is outside the scope of these guidelines. Reference can be made to work being conducte at EU level.	N/R
	Respondents mention that "highly liquid" should be assessed in good faith by the bank in terms of conditions existing from time to time; the guidelines should not be so rigid as to create audit or examination problems for banks using best efforts to cope with difficult market conditions. Moreover, for the avoidance of doubt, it should be made clear that the commercial concept of "highly liquid" would include the capability to sell or repo an asset (directly or via triparty repo arrangements), or to transact with the central bank in its normal open-market operations.	The principle-based nature of these guidelines indicate that "highly liquid" should be assessed by the institutions, but also expatiated upon by the supervisors. CEBS agrees that "highly liquid" assets would be assets which should be sold or repo-ed (directly or via triparty repo arrangements) and transacted with the central bank in its normal open-market operations.	See Annex 2
	Comments contain requests for clarification of the meaning of central bank measures falling under the concept of "emergency facilities" (paragraph 58).	Outside the scope of this paper	N/R
Para 59 (new para 64) Conditions regarding access to central bank facilities.	Some comments state that provisions for liquidity buffers need to take into account the exercise of discretion by central banks depending on their mandates. In some systems, a firm can access central bank facilities without restrictions as long as it has the collateral required. In other jurisdictions, central banks can deny access to firms under certain circumstances, especially if they are believed to be insolvent. This discrepancy can cause ambiguity and uncertainty for firms operating under the umbrella of different central banks. It is suggested that there should be a clear delineation of conditions regarding access to central bank facilities. Comments point to the guidelines, paragraph 59, where banks are required to test periodically whether central banks will effectively provide funding against eligible assets as collateral under stress	The guidelines para 59 (new para 64) state: "It will be important for banks to have a clear understanding of the terms and conditions under which central banks may provide funding against assets eligible as collateral under stress conditions. Banks should test periodically whether central banks will effectively provide funding against such assets and should apply appropriate haircuts to reflect the amount of funding that central banks might actually provide in stress scenarios (for the assets in question	N/R

Draft Text CP28	Received Comments	CEBS's Analysis	New text (proposal)
	conditions. Given that such collateral often consists of portfolios of assets, more indications about how to conceive such tests on central bank eligibility would be welcome. Particularly amongst large, internationally active banks, the implementation of tests for each individual asset would result in an enormous effort and create additional costs which would not live up to a cost-benefit analysis. Furthermore, it cannot be ruled out that the implementation of actual transactions for testing purposes would send undesired signals to the market which could potentially have an adverse affect for banks. Respondents would appreciate a specification as to how the ongoing tests of central bank eligibility should take place	and for the banks themselves)." For buffer purposes, banks have to be careful regarding funding from ordinary central bank operations for short term buffer purposes. Central bank operations are often fixed at certain week days or certain dates. Banks can also risk not obtaining bids in auctions, due to mis-pricing. A delineation of conditions regarding access to central bank facilities is outside the scope of these guidelines	
	In paragraph 59, it is specified that banks should not rely "too heavily on access to central bank facilities as their main source of liquidity". CEBS's concerns are understood from the perspective of the role of central banks as "lender of last resort". However, it is suggested that the fact that the regular participation in open market operations should not be interpreted as a close dependence of central banks should be clarified. Development of criteria that would indicate a strong reliance on central bank facilities will be welcomed.	CEBS agrees that regular participation in open market operations should not be interpreted as a close dependence on central banks.	Amendment to the text in para 59 (new para 64) last sentence: "Regular participation in open market operations should not be interpreted per se as a close dependence on central banks."
	Guideline 5 (diversification of assets)		
Para 61 (new para 66) The relationship between short term liquidity buffers based on internal stress tests and regulatory requirements	Comments point out that in paragraph 61, two buffers are mentioned; one for the business as usual liquidity risk management and a regulatory buffer that should be complied with at all times. This creates the impression that there should be two separate buffers, where the regulatory buffer is not to be touched (i.e. dead capital). In practice, there is only one buffer which is used for internal liquidity risk management as well as for achieving regulatory compliance. Respondents are of the view that the entire liquidity buffer should be available for an institution to generate liquidity if it needs to. If the institution should fall below the regulatory requirements, this should be addressed in the one-to-one relationship with the prudential supervisor.	In para 61 (new para 66) the guidelines say that "the liquidity buffer should be calculated as an excess over any regulatory requirement." If there is a conflict between the buffer definition and the regulatory requirements, the portion that is in conflict should be held on top of the regulatory requirements.	N/R
Para 62 – 63	Respondents agree with CEBS that a sufficient diversification of the assets in the liquidity buffers is important for marketability.	CEBS do not necessarily agree with this point. The overall purpose of the short-	N/R

Draft Text CP28	Received Comments	CEBS's Analysis	New text (proposal)
(new para 67 – 68) Diversification in buffer assets	Notwithstanding the foregoing, some respondents were of the opinion that the request to avoid large concentrations of securities even if they are central bank eligible would have to be revisited. In their view, a concentration in these securities can be deemed safe, provided it stays within the concentration limits established by the central bank.	time liquidity buffer is to be able to sell the assets in the market quickly and without adopting fire-sale prices. Therefore, the institution should secure a diversified portfolio based on its own definitions and not rely on concentration limits established by central banks for collateral or other purposes.	
	One respondent mentions that it may be hard for some firms to avoid holding large concentrations of particular assets if the definition of eligible assets is too narrow, limiting the possibility of diversification. There are already indications that some countries, even within Europe, would limit this to local state obligations, which is both at odds with the single market and inevitably going to cause concentrations of assets that may be vulnerable to the ratings and market standard of the sovereign or other eligible local issuers**.**	CEBS recognises this point as a possible danger. National regulations are outside the scope of this paper.	N/R
	One respondent advocates that where a money market fund is invested only in government securities, investment in that fund should be eligible for inclusion in a liquid assets buffer. It is requested that the proposals are amended to reflect this.	There guidelines are principle-based and do not go into detail defining specific assets eligible for buffer purposes.	N/R
Para 64 **(new para 69)** Active market participation	Some respondents state that the requirement set out in para 64 that firms should seek to be active on a regular basis in each market in which they hold assets for liquidity purposes seems to be excessive for smaller and retail-oriented institutions. In some countries these banks belong to a financial network and part of their market access only takes place through the central institutes. Those institutions would face high transaction costs in relation to the traded volume. Even institutions which are more capital market oriented and central banks should only be required to adhere to this requirement at random.	Every institution should be active on a regular basis in each market in which they hold assets – even smaller banks. We will, however, believe that, based on the proportionality principle, smaller banks that access markets through another institution will, in most cases, not have to be active in several advanced money – and capital markets.	New footnote to the last sentence in para 64 (new para 69): "Based on the proportionality principle, smaller banks that access markets through another institution will in most cases, not have to be active in several advanced money and capital markets"
	Guideline 6 location and size of buffers within a banking group		
Para 67 – 70 **(new para 72 – 75)**	Some comments raise concerns relating to international cross border banks and any limitations which may impair the free flow of liquidity within a group. The variety of specific local liquidity requirements and the degree of harmonization of international	These guidelines are guidance for institutions. National liquidity regulations are outside the scope of this paper. Please refer to CRD work at	N/R

Draft Text CP28	Received Comments	CEBS's Analysis	New text (proposal)
Location and size of buffers within a banking group	operating requirements and collateral criteria were mentioned as important determinants of the efficiency of global systems. Other respondents mention the text in the guidelines saying that the location and the size of the liquidity buffers within the banking group should adequately reflect the structure and activities of the group. In one respondent's view, this provision also implies that the liquidity buffers may be presented at an aggregated level for the banking groups. A clarification would be appreciated.	EU level	
	A clarification is also asked for regarding the interpretation of the language "self-sufficient in terms of liquidity" in paragraph 67. One view expresses the idea that only legal entities should be subsumed under the term "self-sufficient".	This is dependent on policies implemented by national regulators and outside the scope of this paper.	N/R
	Respondents ask for coordination of regulators and supervisors in the direction of harmonisation of practices and to contribute to a more efficient treatment of cross border firms, and finally improve communication amongst supervisory colleges.	In June 2009, CEBS published a paper on a Liquidity Identity Card aimed at providing supervisors of European cross-border groups with a single prudential language in order to enable meaningful exchanges of information in going-concern situations, in particular within colleges of supervisors. This will also be a useful tool for the broader exchanges of information between home and host supervisors that are required by Article 42(a) of proposed Directive 2006/48/EC[2]. It should also capture any specific actions taken by host supervisors in the context of Article 30 of the same directive.	N/R
	VI. Annex – Cash flows and counterbalancing capacity		

[2] The work on the Liquidity ID served as the basis for a response to the European Commission's call for advice on the implementation of Article 42, as far as liquidity is concerned.

Draft Text CP28	Received Comments	CEBS's Analysis	New text (proposal)
	In some respondents' views, the proposed differentiation between contractual and behavioral cash flows does not give rise to greater knowledge about the liquidity situation, nor would it be reasonable for it to be applied in the case of retail banks with sound deposits.	CEBS does not necessarily agree with this view. The institutions should develop cash flow projections covering expected cash inflows and outflows and expected counterbalancing capacity. This is the basis for day-to-day management and for the stress test exercise. For some assets and liabilities with optional characteristics, assumptions about behavioural cash flows can be important.	N/R
	Answers to Questions		
Q 1 - 1.1	**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 central bank eligible:** **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? Would there be 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 disproportionately large high quality liquidity buffer consisting of assets whose yield was significantly lower than the institution's costs of funds.	Clear quantitative studies can not be done, because we are not setting any quantitative parameters for the stress test or the buffers. See the introduction to the guidelines.	
	By introducing a restricted definition of the liquidity buffer, a European financial institution may need to recalibrate their holdings in order to meet the CEBS's 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 will need to be kept to maturity.		
	There is no incentive to hold assets that cannot be eligible for the buffer, which as a consequence will deteriorate in price and value		

Draft Text CP28	Received Comments	CEBS's Analysis	New text (proposal)
	and will be illiquid, whereas the opposite effect will occur in relation to liquid eligible assets in the so called survival period. In times of stress, rating of government debt issues may also imply a risk for banks domiciled in lower rated EU Member States since banks will have to exchange local government debt for foreign better rated government debt. Therefore, a squeeze in available highly liquid assets may increase in consideration of this factor. Additional funding required to meet liquidity buffer requirements will compete directly. Additional funding required to meet liquidity buffer requirements will compete directly with other activities such as the hedging of illiquid assets or lending the economy at a time where issuers, which do not have access to such markets, will request more bank loans. Another effect will be an increased demand for capital funding between other capital requirements such as leverage ratio and dynamic provisioning.		
	Questions were raised as to whether there will be enough government bonds to guarantee a one-month survival period for all the European banks? The supply of government bonds may be abundant now, but it might significantly decline in the coming years due to potentially restrictive fiscal policies undertaken by the governments. The buffer-driven demand for government bonds might also significantly change over time, if the banks adjust the whole structure of their balance sheets in accord with the new rules. One of the most obvious consequences of narrowing the eligible assets class will be the widening of the gap between the liquid and the less-liquid bonds, both within the same bond class (i.e. on-the-run vs. off-the-run government bonds) and between different bond classes (corporates vs. govies).		
	In the coming period we do not foresee a shortage of eligible assets. Yet, we do expect an increase in the market price of these assets due to increased demand. Based on aggregated data of the Dutch financial sector - including foreign operations - we expect a significant impact which could result in more than EUR 100 bn of additional high quality assets.		

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Q I - 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?**		
	No respondent has provided any complete comment to this question.		
Q1 – 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)**		
	Several respondents point out that – the principles proposed by CEBS for the assets eligiblefor the liquidity buffers are essentially appropriate. Before fixing a more narrow definition of the liquidity buffer, there should be an analysis of the vertical and horizontal scope of the relevant market. In addition to this, banks would have to be granted a reasonably long time horizon for acquisition of eligible securities without significant market interference and for a sale of securities that are no longer eligible for recognition in a way that is benign for the market	Clear quantitative studies can not be done, because we are not setting any quantitative parameters for the stress test or the buffers. See the introduction to the guidelines.	
	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 it will take for the sector to adjust without distorting the market.		
	Given the current economic climate, we feel there should be a gradual transition. This should be spread out over a period of at least 24 months, with a proper macro-prudential oversight A transition period of a couple of years would also 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.		
Q 2	**Would you consider that a too narrow definition of assets eligible to for 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	Clear quantitative studies can not be done, because we are not setting any	

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	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 classifying government bonds would be that all issues of EU sovereigns are treated in the same way in order to avoid concentration of liquidity buffers in particular issuing countries and impede sufficient diversification.	quantitative parameters for the stress test or the buffers. See the introduction to the guidelines.	
	A narrow definition will favor the holding of government debt parallel to a reduction in availability of highly liquid assets, with adverse effect of lending capacity to decrease significantly while exposure on government bonds may have a macro-economic impact. There is indeed a substantial risk of negative impact on the real economy of overly restrictive liquidity buffer requirements.		
	The increased demand for highly liquid securities can also cause shifts in the issuer markets. Depending on whether or not the securities of an issuer are eligible for the liquidity buffers, this can have a considerable influence on the demand for and liquidity of these securities. Here, also a potential differentiation between states as issuers of bonds may play an important role.		
Q3	**How would you assess the reference to central bank eligibility for the purpose of specifying which assets should be eligible to for the liquidity buffers?**		
	The quality of the asset should be a more important driver for central bank eligibility than market liquidity.	See Annex 2 to the guidelines	
	It is an economic reality that central banks are the only institutions that can create liquidity when the private markets are failing. Therefore, financial institutions must have access to an alternative route to liquefy the assets in the liquidity buffer when the private markets are failing. Accordingly, 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.		
	Long-term buffers should also include less liquid assets which might not even be central bank eligible. In an idiosyncratic stress scenario such assets could still be sold into the (still functioning)		

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	market as the quality of the asset itself is not negatively affected.		
	Central bank eligibility is not necessarily synonymous with liquidity in the market, under stress conditions, for example, for loans, ABS and self-securitizations which central banks accepted as eligible assets in the past during the turmoil. Nevertheless, for the other type of assets, as it is very difficult to forecast the market liquidity under a range of stress conditions, banks will not have any other choice than to use the "Central Bank eligibility" criteria as a benchmark for "market liquidity" criteria. These eligible instruments should include bonds issued by central governments, Central Banks, local and regional governments, jumbo covered bonds, agencies, supranational counterparties, traditional covered bonds, corporate and credit institutions. The difficulty is in determining the objective criteria (counterparty rating, depth and breath of each specific market...) to forecast the market value under different stressed conditions and different horizons. One lesson of the recent systemic crisis was that major European government bonds became illiquid in the market.		
	An alternative to a narrow definition would be to bring more flexibility and subjectivity on a case by case basis and to consider other sources of assets that are not tagged as highly liquid assets, subject to CEBS's definition.		
20 – a	**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:** **How does the return on liquid assets compare to the return on less liquid assets? Do you anticipate a (significant) impact on ROE?**		
	The more restrictive the list of securities eligible for liquidity buffers, the greater the 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 spread widening.	Clear quantitative studies can not be done, because we are not setting any quantitative parameters for the stress test or the buffers. See the introduction to the guidelines.	N/R

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	The return on assets depends on whether or not the higher demand can be met by increased supply. Should banks primarily draw upon government bonds for building up the required liquidity buffers then we expect a significant increase in the acquisition costs for first-grade government bonds. This would translate into shrinking ROEs.		N/R
20 – b	**Do you believe that CEBS's proposals could lead you to restrict your lending capacity or increase the cost of financing for borrowers?**		
	Liquidity buffer requirements will probably generate three types of adjustments: an increase in the amount of the liquidity buffer, an increase in medium term debt and a decrease in credit capacities, likely to trigger a credit crunch.	Clear quantitative studies can not be done, because we are not setting any quantitative parameters for the stress test or the buffers. See the introduction to the guidelines.	
	If the assets eligible for the buffer will be restricted to those which are "highly liquid in private markets and central bank eligible", it may well be the case that the CEBS's proposals will end up restricting banks' lending capacity and/or increasing the cost of financing for our borrowers		
	We expect the spread between buffer eligible assets and lending, and consequently the cost for banks, to increase due to a narrow buffer definition.		
	According to Principle 4 of the document entitled "Principles for Sound Liquidity Risk Management and Supervision" published in September 2008 by the Basel Committee on Banking Supervision, banks should incorporate the liquidity costs in the product pricing, performance measurement and new product approval process. Higher liquidity costs which are triggered by large liquidity portfolio holdings should be allocated accurately to the party which incurred them. This will drive up product prices and hence significantly impact lending. As noted above, more stringent requirements with regard to the amount of liquidity that has to be kept available by banks will translate into lower ROEs for said banks. To compensate for this shortfall, banks will, therefore, seek more risky transactions. Furthermore, the additional securities holdings also require backing with regulatory capital. More likely than not, this will have an equally dampening impact on lending. Reduced levels of credit available to customers will leave unmet demand for financing, which would lead to increased financing costs, as well as the obvious effects on the real economy.		N/R

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20 - 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 business models. Nevertheless, the changed cost structure will impact individual business and may flip a marginal profitable business into a loss making business. The managerial response to this may differ per business/product mix.	Clear quantitative studies can not be done, because we are not setting any quantitative parameters for the stress test or the buffers. See the introduction to the guidelines.	
	Very likely any business that deals in illiquid assets (as defined by their eligibility for the buffer) will need to alter its business plan and risk appetite to take into account the new requirements to hold more liquid securities, but the extent and the dimensions of that impact depend, in part, on interaction with capital, leverage, accounting and other requirements. There may also be knock-on effects on collateral policies and the like, which will need to be added in.		
	CEBS's proposal presents level playing field issues for those banks that, to date, have not kept sufficient liquidity buffers in place which would allow them to survive a variety of stress scenarios. On the other hand, the playing field would tend to improve for those banks which already have large liquidity buffers in place.		
	There would be a risk of competitive distortion in the event of a heterogeneous interpretation and application of the provisions by the international banking community. Cross-border banks that manage their liquidity risk at a central level might need to change their business model to some degree if they were faced with local requirements for liquidity buffers that were unharmonised or even protective.		
	Regarding competitors, there might be negative impacts on the yield of portfolios of insurance companies and investment funds in the case of investments in highly liquid assets. The CEBS's Guidelines induced change in the returns on securities, such as the expected reduction of the return on first-grade government bonds. This could also impact the investment behavior and investment companies' potential yields		N/R

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20 - d	**Do you consider that these Guidelines can help to restore confidence in the interbank market? To improve funding costs?**		
	Available liquidity currently traded between banks might be used for investments into long-term securities and, therefore, withdrawn from the money market. Collateral which is used now for Interbank Repo business might be blocked for a liquidity buffer.	Clear quantitative studies can not be done, because we are not setting any quantitative parameters for the stress test or the buffers. See the introduction to the guidelines.	
	Collateral used for central bank activities might be blocked for the buffer which will restrict access to cheap funding (based on pre-Lehman levels).		
	Guidelines which give incentives to invest in a higher fraction of highly liquid portfolios should improve the confidence between banks and could lead to higher trading activities based on restored credit limits. As long as implementation is done in incremental steps and based on realistic analysis of the impact of these guidelines on the markets for all securities and the firms themselves, then confidence can be restored.		
	New liquidity guidelines and capital rules, together with other measures that are already in place, have the potential to stabilize confidence in the interbank markets. This process may well lead to some decrease (*ceteris paribus*) in the cost of interbank funds for many banks. Higher liquidity buffers alone will not be sufficient to restore confidence.		