



**European Financial Services
Round Table**

Response of the EFR

**Second part of CEBS' technical advice
to the European Commission on liquidity risk management**

Modernisation and alignment of liquidity regulation for credit institutions

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European Financial Services Round Table

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Belgium

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Dear Sirs,

EFR Members welcome the opportunity to comment on the second part of CEBS' technical advice to the European Commission on liquidity risk management, dated 17 June 2008.

Modernisation and alignment of liquidity regulation for credit institutions

The banking members of the EFR acknowledge that liquidity risk played a major role in the recent turmoil on the financial markets. We welcome the opportunity to share our views on the ongoing consultation of CEBS concerning supervisory guidance for the management and supervision of liquidity risk.

The Commission intends to take this supervisory guidance on risk management into consideration for the review of the Capital Requirements Directive (CRD) by the end of 2008. The banking members of the EFR would like to stress the importance of a truly risk-based and harmonised prudential regime.

We believe the guidance and regulation should aim at two objectives:

- The supervisory approach to liquidity management should be modernised: principles-based liquidity regulation should be introduced that allows for the use of bank-specific approaches to liquidity management based on internal control systems and methodologies.
- Such principles-based liquidity regulation should be employed not only by all supervisors in the EU but also worldwide, and form the basis of a harmonised approach to the supervision of liquidity management for cross-border groups based on a much enhanced centralisation and integration of group-wide supervision under the lead supervisor concept.

Modernisation

We believe banks should have the option to use internal control systems and methodologies for liquidity management. Such a possibility exists in Hong Kong and has recently been introduced in Germany, where sophisticated banks will have the option to use their own control systems, rather than following simple (if not simplistic) rules, as is the case with most of the existing liquidity regulations in the EU. Such simple, yet overly detailed and prescriptive rules no longer do justice to different business models and the liquidity requirements stemming from these. The proposals on liquidity management presented by the IIF in 2007 as well as the approach currently implemented in Germany provide useful starting points for modernised liquidity regulation.

A greater reliance on banks' internal approaches would go hand-in-hand with a need for greater disclosure of the systems and methodologies employed by

banks. Undifferentiated pressures for greater disclosure should, however, be resisted, in particular as regards the disclosure of banks' actual liquidity positions, as a disclosure of weak liquidity positions could become self-fulfilling. Greater reliance on banks' internal approaches also entails qualitative requirements including in particular a strengthening of internal control mechanisms. Given the considerable range of bespoke, firm-specific systems and methodologies, much comfort can and should be taken from strict use-test requirements.

The recent market dislocations have intensified discussions on improvements to banks' liquidity management and to the instruments available to central banks in this area. As regards the former, this concerns areas such as the use of stress-testing and the internal pricing of contingent liquidity options. These issues largely lie in the responsibility of banks themselves. However, as they are also assessed at the discretion of national supervisors, an alignment of supervisory approaches to these issues would be welcome.

As regards central bank instruments, issues that should be covered include the following:

- Banks should be allowed to use common pools of collateral, i.e. collateral is held centrally with one central bank within the EU, but can be used in open market operations with other central banks.
- The range of eligible collateral should be harmonised between central banks (within the Eurozone, eligible collateral is already fully harmonised, but there may be a need to further align actual collateral practices).
- There should also be, as part of a non-exclusive list, a convergence of approaches to cross-currency collateral, to applicable haircuts, and to policies on maturity of lending.

Finally, when drawing up the basic principles for liquidity management, regulators should take a holistic approach that also takes into account the impact of solo level capital and (intra-group) large exposure requirements. Without consideration of these other requirements, the benefits of a move to a principles-based liquidity regime that allows for an integrated group-wide approach to liquidity risk management could be significantly curtailed, by restricting the ability of groups to fund subsidiaries or for the subsidiaries to pass on excess liquidity to other group companies.

Alignment

For efficiency reasons, cross-border banks have a strong interest in a consistent and unified supervisory approach in the area of liquidity management. This approach should draw on and evolve with market practices that are increasingly marked by a greater centralisation of liquidity management (to the extent possible, where not limited by liquidity positions in less fungible currencies). Incidentally, this centralisation of liquidity management has gone hand in hand with a greater centralisation of risk

management more generally. Recent market events have underlined the importance not only of a firm-wide but also a fully integrated approach assessing and managing risks across different risk categories.

EU Member States should therefore develop a harmonised supervisory approach to liquidity management at the EU and ideally the wider international level. In this regard, the intention of the European Commission to integrate the upcoming supervisory guidance into the CRD review is most welcome. The initial development and subsequent maintenance of this harmonised supervisory approach should draw on the range of observable market practices and should follow future innovation and sophistication of these practices.

The principles-based regulatory framework should (i) abolish the host-country control for liquidity management over branches, (ii) result in an increase in the dialogue between home and host regulators to better understand where subsidiaries are impacted by the liquidity attributes of the group as a whole, and (iii) and underpin an integrated and centralised supervisory approach in line with the increasingly centralised and integrated risk management practices regulators are encouraging.



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Members of the **European Financial Services Round Table (EFR)** are Chairmen or Chief Executives of leading European banks and insurance companies. The EFR believes in the creation of open and competitive markets for financial services both within Europe and in a global context. We want to ensure that Europe is a highly attractive environment for financial services companies to base themselves.

Chairman of the EFR is **Michel Tilmant**, Chairman of the Executive Board of ING Group.

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