

August 1, 2008

Ms. Kerstin af Jochnick  
Chair  
Mr. Arnoud Vossen  
Secretary General  
Committee of European Banking Supervisors  
Floor 18 Tower 42  
25 Old Broad Street  
EC2N 1HQ London United Kingdom



Re. *Second Part of CEBS'S Technical Advice to the European Commission on Liquidity risk Management*—Draft for consultation

Dear Madam and Sir:

This letter is submitted in response to the Committee of European Banking Supervisors' public consultation on its advice on liquidity risk management, particularly the second part of its response to the European Commission's Call for Technical Advice (No. 8). This letter is based on discussions with members of the IIF's Working Group on Conduits and Liquidity Risk Issues and our Task Force on Home/Host Implementation Issues.

We note that the proposals contained in the consultation paper are generally consistent with the Basel Committee's *Principles for Sound Liquidity Risk Management and Supervision*. As we noted in a similar response letter to the Basel Committee's parallel draft consultation report, Institute members are in agreement with the main thrust of the recommendations set forward in the consultation paper while seeing a need to voice certain concerns, arranged by reference to the relevant recommendations. A few general comments regarding the text precede the discussion of specific issues.

A fundamental point that cannot be overemphasized is that any new liquidity regulation or supervisory approaches should be harmonized to the maximum extent across all the major markets, both within the EU and beyond. We know that CEBS is well aware of, and working with, the Basel process, but we stress our view that international harmonization should be among the highest long-term priorities of all authorities working on these issues. While we realize the limitations of CEBS's remit, we consider that its efforts could provide leadership in the elimination, at least over time, of remaining blanket quantitative liquidity tests. It is very important, in the interest of efficiency from the firms' point of view, in the interest of effectiveness of regulation and in the interest of reducing liquidity issues in the system generally that there not be major differences of regime across the major systems and currencies.

For a further discussion of many of the specific technical matters raised in the consultation paper, we refer to the recently published *Final Report of the IIF Committee on Market Best Practices* (July 2008), which incorporates and updates the recommendations of the Institute's *Principles of Liquidity Risk Management* (March

2007). We note with appreciation that the consultation paper mentions the value of the March 2007 report, and cites that report for a number of points.

### General Comments

The consultation paper is very constructive and in line with the liquidity-risk management views expressed in the IIF's reports on liquidity, and that the principles contained in the text, if adopted, should contribute to harmonization of practice, both in the industry and among supervisors. We also note that the guidance offered in this consultation paper is generally presented in a principles-based manner, subject to certain reservations below. We applaud this approach. As argued before, the realities of liquidity risk management make it especially important to have a rigorous, critical but principles-based supervisory oversight approach.

A general comment on the consultation paper is that each of the thirty high-level recommendations contained in the text contains many sub-recommendations and clarification is needed as to the intent and scope of certain sub-recommendations to avoid overly prescriptive interpretation that would lead to inappropriate "micro" regulation. We also believe it is necessary to emphasize the proportionality of all the recommendations. Guidance should emphasize further the need to apply recommendations in a proportional way, which balances the mix of business, products, culture, sophistication, capabilities, capacities and size of firms such that the recommendations would not be applied to all firms in the same way.

We do note with approval that the consultation paper allows for variances in firm composition, jurisdiction and circumstances. For instance, *Recommendation 20* suggests that supervisors take into account "the liquidity risk profiles of institutions, in order to apply a proportionate approach to their supervision" (boxed text on page 56). Per the language of *Recommendation 23* and in connection with assessing the quality of liquidity risk management and supervisory attention to the firm's liquidity risk program, especially for stressed situations, the consultation paper states, "what is adequate for an individual institution depends very much on proportionality (meaning that the complexity of stress testing should to be related to the size of the institution and the sophistication and diversity of its activities) and the development of its practices over time" (paragraph 234)."

Additionally, we note *Recommendation 26*, where proportionality is reflected with respect to less-sophisticated institutions: "under the proportionality principle, supervisors may consider their standardized regulatory approach (if they have one), as a key element in the internal liquidity risk management of less sophisticated institutions" (boxed text on page 61). We certainly agree with the application of proportionality to smaller institutions; however, we would caution that recent experience suggests that the availability of standardized alternatives for such institutions implies some supervisory burden to make sure that this does not lead to overlooking substantial risks. As we have argued many times, standardized (and simplified) quantitative measures can be

misleading and give false comfort; therefore, use of such alternatives requires rigorous oversight.

Members are concerned about expectations for implementation of the recommendations, concluding that full implementation in a highly detailed manner by 2010 would be unworkable. We believe that there needs to be a certain level of pragmatism connected with the timetable for implementation, particularly as firms work within local regulatory frameworks.

We are concerned that the language throughout the consultation paper should be clearer on the point that materiality is always an issue. While we are confident that CEBS appreciates the importance of applying a materiality test, at many points the text seems to say that “all” positions or exposures, etc., should be captured, but this is neither practical nor necessary nor proportionate in many cases. Insufficient stress on the distinction between material and non-material issues could lead to important modeling, IT and practical challenges with little or no added value. We believe strongly that it would be helpful to focus on materiality and make clear that specific aspects of firms’ compliance are appropriately subject to materiality assessment. Each firm should define materiality as appropriate in its own context, subject, of course, to rigorous supervisory review.

We also note the use of the term “retail deposits” through the consultation paper. Instead, or in addition, we would recommend use of the term “core” or “relationship” deposits. Some types of commercial, corporate and institutional deposits can exhibit stickiness that is comparable to some retail deposits. It would also be appropriate for the paper to recognize that levels of stickiness should, as discussed by the 2007 IIF report, be assessed from time to time for different types of retail deposits (e.g., for brokered deposits and internet-based accounts).

Another term used throughout the consultation paper is “wholesale funding.” We believe that any analysis of reliance on wholesale funding should consider the terms for which the funding has been issued (i.e., short term versus long term, and the degree of usage of the firm’s estimated capacity). Any concerns with depositor, product, currency or market concentration are not *necessarily* best addressed with limits but possibly with target, ranges or on-going monitoring processes that provide the required flexibility in evaluating related risks in light of existing circumstances. In addition, as stated above, relationship issues are important in assessing wholesale funding. The term and expected liquidity of the assets funded with wholesale funding should also be considered.

The consultation paper makes an important contribution in recognizing the costs of mitigating liquidity risk (see, for example, *Recommendation 7* on the effects of risk mitigation), which has not always been the case in post-turmoil official discussions.

The point is so basic, however, that we reiterate that full mitigation of liquidity risk is not possible and attempting it would impair a firm’s ability over time to compete, and deplete its ability to maintain adequate liquidity and participate in maintaining the liquidity of the market and to make credit readily available. Given some of the root causes of the recent

crisis from a liquidity-risk perspective, we understand why the focus of the consultation paper is on improving the control and mitigation of liquidity risk. In light of the recent increases in costs of mitigation, which are material and are most likely to be around for at least a while, it is important to recognize that there is still, irrespective of recent events, a need to find an appropriate balance between risk mitigation and cost of mitigation.

Finally, absent from the consultation paper is any discussion of “trapped pools of liquidity”: the fact that surplus cash and collateral may be available in national systems but not available to firms on a group-wide basis for legal, regulatory or practical reasons. While it may not be possible in present circumstances for a variety of reasons entirely to eliminate this problem, it would be constructive to build a consensus that liquidity resources needed for local purposes should be analyzed on a “minimum necessary” basis to free up to the greatest extent possible global pools of cash and collateral to protect against liquidity crisis and contagion in the global system. This is consistent with the recognition in paragraph 56 of the consultation paper, the recent FSF report and many other statements that group-wide management of liquidity risk has become essential (see, for instance, page 72 of the recent IIF report).

#### Nature and definitions of liquidity and liquidity risk.

Paragraph 4 introduces the concept of a “liquidity buffer” but in an open-ended way. While the discussion is not unhelpful, the concept has become so important in post-turmoil discussions that further discussion may be in order.

As a general matter, “buffers” would be built up in benign conditions and drawn down in stressful times when it would be difficult to build up, but these (counter) cyclical effects should be given more attention to avoid undue pressures in times when buffers are being drawn down.

Assets available for “buffer” purposes would typically be cash and unencumbered, highly liquid assets available to meet unanticipated excess liquidity needs either by sale or pledging, under a variety of liquidity stress scenarios. Recent markets have of course affected assumptions about what can be considered liquid for these purposes, and have also shown the importance of central bank liquidity facilities in extraordinary conditions.

As a matter of normal liquidity-risk management, assets deemed liquid before their contractual maturities are given haircuts to recognize sale. “Cushion” assets would be expected to be assets that are normally expected to be highly liquid, with stable haircuts under most or all possible scenarios. Yet the “cushion” so understood could be very restricted indeed. It should not rule out other assets being given liquidity value under normal or less-extreme stressful conditions. It is appropriate to make a distinction between assets that are sufficiently liquid in all conditions and those that are liquid in many but perhaps not all conditions that are available to help manage liquidity. The firm’s liquidity-risk appetite should recognize these distinctions, assigning the highest price to the scarcer buffer assets.

There is, however, clearly a risk of setting the liquidity-buffer test at such a demanding level as to be incompatible with the firm's overall appropriate profitability goals, or to make it uneconomic to participate in the very activities that sustain the liquidity of the overall market, or to maintain an orderly and conservative but realistic liquidity ladder. While CEBS clearly recognizes this, it should be made clearer that firms have strategic trade-offs to be made, within reasonable but not absolute prudential bounds.

Specification of the "survival period," referred to in paragraph 4, is one of the critical aspects of a firm's definition of its liquidity-risk tolerance.

Paragraph 20 of the introductory remarks and *Recommendation 25* (discussed further below) provide for supervisory assessment on internal methodologies of firms. Especially for complex financial institutions, regulatory emphasis should be on obtaining and evaluating information from a firm's internal reporting framework. Firms manage their liquidity differently depending on mix of business, international presence, market participation, capabilities, capacities and business models and risk tolerances. This is a fundamental point that could perhaps be developed further.

For complex financial institutions, we believe that regulatory emphasis should be on obtaining and evaluating information derived from a firm's internal reporting framework. We would encourage CEBS, therefore, to recommend as emphatically as possible that supervisors rely on internal methodologies in their evaluation of the liquidity risk of institutions, subject to regulatory assessment. As we have often noted, firms' liquidity needs and strategies vary widely for good business reasons. Using a standard approach is contrary to the fact that firms manage their liquidity differently based on their business models and risk tolerances. Any such standard measures are not likely to be truly comparable between firms and could potentially be misleading. For example, this could be re-emphasized in paragraphs 220 and 221. Paragraph 22 is helpful in noting that there is no single best practice, but undermines the essential point by accepting static indicators that, we believe most strongly, can often be misleading. While we recognize the limitations of CEBS's charge, we are also concerned that such reference, though probably intended to be merely factual, could be taken as unwarranted approval.

Paragraph 33 is not correct in stating that "no" public information is available for CDOs traded over the counter. Reference should be made to the ten transparency initiatives recently announced by the European Securitization Forum (see "Industry Initiatives to Increase Transparency Issuer and Investor Transparency Initiatives," June 28, 2008, accessible from the website of the European Securitization Forum). Similarly, part VI of the 2008 IIF market-practices report discusses directional developments in enhancing the transparency of the market.

A similar issue comes up with respect to *Point of Interest 4* (boxed text page 19), which asserts in a conclusory manner that use of derivatives and complex products may reduce the transparency of firms' liquidity positions. While this is perhaps true to some degree and we do not intend to enter into a lengthy defense of the use of derivatives, and while

they certainly engender liquidity challenges, we would question the advisability of making such overly generalized and essentially simplistic statements in a political comment where they can easily be misunderstood. Despite problems, derivatives remain absolutely essential to firms' risk management and care must be taken not to contribute, however inadvertently, to the unsophisticated reactions to such market instruments that seem to be emerging.

Similarly, paragraphs 35 through 38 on use of securitization, though not wrong per se, need to be presented carefully to avoid misperception. As the FSF report and many other official-sector statements have acknowledged, securitization is and will remain an essential part of the credit-generation engine of the European economy. Many securitization transactions have continued to perform well, and to provide essential risk transfer. Thus, the correct observations made in these paragraphs need to be couched in terms that will not contribute to reflexive and ill considered anti-securitization moves (see part D.III, "Liquidity Risk, Conduit and Securitization" beginning on page 52 of the 2008 IIF report).

We are concerned that paragraph 45 takes a one-sidedly negative view of intra-company liquidity and funding. While certainly there may be cross-border contagion risks, and such risks of course need to be taken into account in firms' planning and stress testing, the ability of a group to move resources among branches and subsidiaries will often be an important source of strength, one that should be recognized and supported (within appropriate prudential bounds). Indeed, as shown by the 2007 IIF liquidity report, group resources, if effectively available and not blocked in one entity or another, can contribute substantially to the group's ability to mitigate liquidity strains as they arise. In other words, the paper should encourage, rather than restrict, the ability of firms to borrow from entities that have excess liquidity on an intrabank basis. Reduction of barriers to the transfer of liquidity enhances the ability of firms to perform effective liquidity-risk management and reduces risk in the system overall. In addition to facilitating liquidity-risk management and increasing the flexibility and resilience of the firm's liquidity response, other benefits of more open intra-company funding would include lower third-party credit exposures, reduced capital requirements, reduced usage of unused funding capacity and more effective balance-sheet management. The FSF report and other recent discussions have emphasized the importance of firms' taking a group-wide view of liquidity and other risks. While centralized liquidity-risk management does indeed need to take into account the issues mentioned, we contend it is overall a powerful defense of liquidity both of the firm and the system. This is recognized to a degree in the last sentence of paragraph 45, but the tone and direction of the paragraph nonetheless need to be rebalanced and refocused.

#### Liquidity Risk Management at Credit Institutions and Investment Firms (Recommendations 1-18)

*Recommendation 1* (boxed text page 27) states that a firm should have a liquidity risk strategy based on the right level of risk tolerance and suggests governance approaches.

As noted in paragraph 76, we are generally in accord with the thrust of the discussion, though we would note occasional lapses into excessive prescriptiveness. For example, at paragraph 81, it is said, “institutions should draw a clear distinction between service centers and profit centers.” While the point that liquidity risk management is essentially a cost (and while, as the IIF 2008 report notes, internal risk pricing for liquidity is an essential management tool), we do not think that mandating an organizational detail such as in paragraph 81 is appropriate. Rather, the issue should be brought to the attention of firms and they should decide how to manage it.

*Recommendation 3* (boxed text page 31) provides a number of good suggestions regarding group liquidity-risk management; however, as with paragraph 45, we are concerned that paragraph 93 needs to be nuanced to avoid being unbalanced. Whereas CEBS certainly recognizes in paragraph 45 and elsewhere that group liquidity risk can contribute to the strength and overall liquidity resilience of the group (and the system), paragraph 93 puts the stress on the wrong points. While certainly, the potential restrictions on free flows of assets must be identified and managed (and, we would argue, diminished by better official-sector coordination over time), it is not appropriate to state that centralized liquidity management should never reduce liquidity held in excess of local requirements from a subsidiary. This would indeed contradict the benefits of group liquidity-risk management, and worsen, rather than lessen, the tendency of “trapped pools of liquidity” to add rigidity and reduce responsiveness not only within groups but also within the international financial system as a whole. We would actually consider the one-sidedness of this recommendation to be at odds with Point of Interest 9 (boxed text page 24), which recognizes the interdependence of liquidity regimes (see the fuller discussion on page 66, “Discussion of Consideration for the Official Sector III.D,” of the 2008 IIF report).

*Recommendation 13* (boxed text page 43) further states that firms should assess the adequacy of their methodology to their risk profiles and risk tolerance.

Also in relation to the question of firms’ assessing the methodologies of their liquidity risk strategies per *Recommendation 13*, it may be helpful to add to that language that it would be preferable to more explicitly recognize upfront the need to identify and consider the probabilities and the degree to which each firm may be exposed to certain events, and how these may materially differ between firms when conducting reviews of liquidity risk management.

*Recommendation 5* (boxed text on page 33) should include “materiality” so the Recommendation might read: “Institutions should have appropriate IT systems and processes that are commensurate with the complexity *and materiality* of specific activities” (emphasized language added).

Paragraph 115 under *Recommendation 7* makes some appropriate comments about securitization covenants that ought to be taken into account in analyzing relevant exposures. Certainly, early-amortization triggers are an issue for both the management and the structuring of securitization transactions, and have caused problems in the recent

turmoil (see the section on “Origination Standards in U.S. Subprime Mortgage Market” on page 88 of the recent IIF report). However, we do not believe that an analytical discussion of liquidity risk management is the place to make prescriptive statements about the appropriateness of instituting certain covenants in transactions. Covenants are intended to protect security holders and are the subject of negotiation in the structuring of transactions. While supervisors have a legitimate interest in the safety and soundness of covenants, any restrictions on covenants should be addressed in the context of a full analysis, taking into account issuers, distributors and investors points of view, and not raised en passant in a document focused on other issues.

*Recommendation 8* (boxed text on page 38) should include other types of commitments such that the Recommendation would begin: “the liquidity risk due to *explicit, formal legal commitments and possible future decisions to take on implicit, reputational or moral exposures* should be taken into account in the overall liquidity risk management framework” (emphasized language added). Note, however, that while it is important to take into account the possibility of future decisions to accept “moral” responsibility, firms should be able to do this as a risk-management exercise without, thereby, being forced to consolidate for accounting or regulatory purposes the relevant exposures.

*Recommendation 8* states, in part, that “institutions should consider whether SPV’s/conduits should be consolidated for liquidity management purposes.” The suggestion that firms should consider measuring these types of liquidity risks on a gross or consolidated basis with the rest of its balance sheet may be misleading. Contingent liquidity risk related to such exposures has to be evaluated and managed, controlled and mitigated but consolidating on- and off- balance sheet risk exposures is not in fact a risk-based approach because positions that are already on balance sheet would be combined in a single report with positions that generally have a remote chance of having to be combined, yielding misleading results. At worst, this route should only be considered in analysis of circumstances when there is an elevated chance that this could occur, (i.e., not under normal course of business but under extreme stressed conditions). As discussed in the IIF reports, there are more effective ways to recognize and manage this risk.

*Recommendations 9 and 10* (boxed text on pages 39 and 40) address intraday risks, which are not addressed in the IIF reports on liquidity-risk management. While the discussion here is generally helpful, it should be noted that management of intraday risk is in effect a separate discipline requiring detailed operational and specialized credit knowledge and will be managed by different groups within a firm, coordinating relevant issues with funding-risk management issues management groups. This point is only noted as a practical matter for supervisory exercises.

We would also like to draw your attention to paragraphs 127 and 128 (the section on “Collateral management linked to payment systems and intraday liquidity needs”) and suggest that these paragraphs, though not wrong, require further discussion to avoid oversimplification; in particular, there should be recognition of the fact that collateral that serves to support intraday liquidity may appropriately also be available to be used (subject to close controls) to support overnight exposures.



*Recommendation 11* (boxed text on page 40) stating that intraday liquidity should be managed on a gross basis is overly simplistic and inappropriately prescriptive. While it is important to have view on gross exposures, liquidity is by definition a net result of the interaction of many processes; thus, the issue is more to identify holes or gaps in liquidity availability than to manage on a “gross” basis as such.

Paragraph 133 under *Recommendation 12* refers to possible linkages of capital to liquidity. Although the point is well understood by CEBS, we reiterate the view expressed in both IIF reports that, except perhaps for remedial measures under Pillar 2 where a firm has failed to put in place good liquidity risk management, there is generally no appropriate direct link between capital and liquidity. Liquidity issues are distinct from capital issues and, generally, capital will not remedy liquidity issues; moreover, as liquidity is in many respects a second-order risk, specifying capital for liquidity issues would result in double-counting. Firms should be well capitalized under the regulatory capital regime, but, with rare exceptions, capital itself is not a substitute for adequate liquidity.

We agree with the assertion in paragraph 134 that there is not really a best-practice model related to the identification, measurement, monitoring and mitigation of liquidity risk. These practices need to be tailored to the firm’s specific business model, risk tolerance and presence in the markets. This is one of the key arguments for adopting an approach that relies on firm-specific models in the supervision of liquidity risk management (see Section D.III, “Liquidity Risk, Conduit and Securitization Issues,” of the 2008 IIF report, with particular emphasis on recommendations III.1 through III.7 on pages 55-57. See also recommendations 14 through 29 on pages 27 through 33 of the 2007 IIF report, which are restated in the appendix of the 2008 report).

Paragraph 145 mentions “innovative stochastic approaches, often referred to as Liquidity-at-Risk (LaR) models.” LaR models may be useful under certain circumstances for market liquidity risk but it is important to make clear that this limited usefulness does not extend to funding liquidity risk. The merits of relying on detailed quantitative models such as LaR to measure funding liquidity risk are questionable, among other issues because LaR is much less developed or widely useful than VaR (Value at Risk, which has its own, well recognized, limitations, of course). Additionally, past experiences within a firm, which are critical to consider when measuring potential volatility of cash flows, are likely not good direct predictors of the impact that future shocks could have on a firm’s cash flows unless it has suffered many shocks in the past. This is in contrast to VaR, where volatility can be measured using market-wide data. Paragraph 136 recognizes that there is no single “best practice” for liquidity-risk management; paragraph 146 recognizes that stochastic models are still at an early stage of development, yet paragraphs 145 and 163 (regarding stress testing) seem to recommend LaR models more strongly than the current state of practice would support, while also pointing to serious difficulties. It always bears repeating that liquidity stresses arise through cash flows, whereas credit and market stresses arise through revenue and capital effects, and thus are quite different and must be analyzed differently. We would suggest that these rather

speculative and somewhat confusing discussions of LaR should either be deleted or perhaps put in an annex addressing “interesting lines of methodological development” or something of the sort. Perhaps at some point a colloquium on methodological issues would be more appropriate.

The concept of liquidity buffers is mentioned throughout the paper but is most notably presented in *Recommendations 15 and 16*, which state: “liquidity buffers are of utmost importance in time of stress, when an institution has an urgent need to raise liquidity within a short timeframe and normal funding sources are no longer available or do not provide enough liquidity” (boxed text on page 48). We note that the term “buffer” is elastic and there is a need to reach a better common understanding of what is a liquidity buffer (see the discussion of paragraph 4 above).

### Transparency to the market

Both the 2007 and 2008 IIF reports discuss transparency in some detail, and need not be rehearsed here in detail. We do appreciate, however, CEBS’s thoughtful discussion, recognizing as it does some of the difficult issues associated with the pros and cons of increasing disclosure requirements, and the limitations of IFRS7. We do wish, however, to note a few places where the consultation paper seems less constructive.

Paragraph 198 appropriately recognizes that liquidity disclosures need the caveat that each firm is managed differently based on its business models and other factors, and that disclosures are not likely to be meaningfully comparable.

In paragraph 202, it is stated that “qualitative information should also include details on information systems, internal controls, and the numbers and expertise of personnel.” While some discussion of these items may be appropriate, there is a real danger that going into too much detail may fall into the trap of demanding “more” information rather than “better” or more useful information. Part of the problems faced by the market in the run-up to the financial turmoil derived from excessive, but less than useful disclosure (as in many structured products), thus there should be an explicit reference to the materiality issue here, and perhaps suggestions as to how to make the information called for manageable and useful, rather than simply requiring more “details.”

Paragraph 204 may be seriously misleading. There is a genuine issue with disclosures of quantitative liquidity information because disclosures of specific positions can, in fact, not only “reveal” weaknesses, but actually contribute to them. This is because of the highly dynamic nature of liquidity information, and the difficulties of making comparisons across firms and over time. For this reason, the IIF reports advise against specific quantitative disclosures and against disclosures of liquidity positions (see Recommendation 13 on page 25 of the 2007 IIF report, restated as Revised and Restated Recommendation on page 133 of the 2008 IIF report). Paragraph 204 talks in terms of “truthful” information, but the issue is not “truthfulness” and, indeed, firms already have many incentives to make certain that the information they disclose is true. The issue is whether there are incentives to deliver information that is both meaningful and useful to

the market. This means avoiding disclosures that could lead to confusing or false comparisons across firms (because mix of business may render a quantitative indicator that is meaningful for one firm worthless for another) or disclosures that would contribute to the problem of information overload in the market, without adding to useful information. Paragraph 205 recognizes this problem, but paragraph 204 creates a serious diversion, and in fact sets up a false problem of “truthfulness.”

Paragraph 207 suggests disclosure of “implicit support” situations; however, this raises a number of very difficult issues of selection of possible (but not committed) implicit support situations that might merit disclosure. It is important not to structure disclosure requirements in such a way as not to force consolidation of off-balance sheet items, or to preclude the use of securitization and other vehicles that provide valuable credit for the real economy, and many of which remain well-controlled despite the turmoil (see the discussion of structured finance vehicles beginning on page 63 of the 2008 IIF report).

Of course, positions and liquidity risk tolerance issues are appropriate for disclosure to and discussion with supervisors, but public disclosures are not necessarily useful to the public or helpful from either a systemic or a firm viewpoint, and must be approached with great caution.

Concerning the language of *Recommendation 18* and as already discussed with respect to paragraph 204 and as developed at length in the 2007 and 2008 reports, we are concerned that specific, quantitative disclosure of “positions” can be both misleading for the market and damaging for the institution’s and the market’s overall liquidity.

#### Supervisory Approach to Liquidity Risk Management and Internal Methodologies (Recommendations 19-30)

Paragraphs 231-237 with respect to stress testing and crisis management are generally appropriate, and we have argued that firms and regulators should work together and communicate clearly with respect to these matters, as this discussion recognizes.

With regard to *Recommendation 25* (boxed text on page 61), we applaud the concept that consideration should be given to replacement of quantitative supervisory requirements by the outputs of internal methodologies, provided that they have been adequately assessed. We would, however, challenge the use of the term “insurance” to describe the comfort that supervisors should seek with internal methodologies. Taken literally, an “insurance” standard would never be met, so the term is misleading. No test, quantitative or qualitative, can provide absolute insurance. The discussion in paragraphs 243-247 is generally very constructive, but we fear that use of the term “insurance” in the recommendation may be misleading and perhaps prevent some supervisors from taking advantage of the very real increase in reliability and control that can be achieved through reliance on well-vetted internal methodologies.

Concerning *Recommendation 29*, we applaud the importance attached to home-host cooperation and convergence. While there are few institutions more aware of home/host issues than CEBS, we would nonetheless like to reiterate the fundamental point that good group management of liquidity is essential, and therefore, liquidity supervisory issues are an especially critical area for home/host coordination, not only within the EU but globally (see Consideration for the Official Sector III.H on page 62 of the 2008 IIF report). As an equally important point, we would like, however, to stress the importance of maintaining the consistency of the European approach with the work being done by the Basel Committee. We know that CEBS is well aware of this, but there is always the danger of subtle divergences, especially where (as is the case) there are many small differences between current Basel and CEBS proposals, despite the general directional consistency. Importantly, this would be consistent with the recommendation of the April 2008 FSF report.

Finally, please note that the members of the IIF Working Group on Conduits and Liquidity Risk Issues and the Task Force on Home/Host Implementation Issues stand ready to meet with you to discuss these or any matters arising from the consultation, and would be pleased to give views or be helpful in any way possible.

Should you have any questions about this letter, please contact the undersigned (dschraa@iif.com; +1 202 857 3312) or Seth Oppenheim (soppenheim@iif.com; +1 202 682 6447).

Very truly yours,

A handwritten signature in black ink, appearing to read "David Schraa", with a long horizontal flourish extending to the right.

David Schraa