POSITION PAPER

ESBG common response to the EBA Discussion Paper on defining liquid assets in the LCR under the draft CRR.

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First of all, the European Savings Banks Group (ESBG) welcomes the opportunity to share its views on this more detailed Discussion Paper on defining liquid assets in the LCR under the draft CRR.

1. General considerations

The ESBG considers that the Discussion Paper on defining liquid assets in the LCR under the draft CRR gives very interesting insight on various methods of assessing the liquidity of instruments, both when it comes to the markets in which the instruments are traded and the characteristics of the individual instruments themselves. We believe that the methodology presented in this Discussion Paper is a good way of underpinning the arguments for the EBA to classify asset classes in the different LCR categories of Liquid assets, e.g. Level 1 or Level 2. However, we are concerned about the real application of these factors when the banks have to measure the market liquidity of every single security on a daily basis given that there might be an excess number of factors. The factors also need to be combined with available uniform data, one thing that the EBA presents as hard to get.

The EBA metrics seem to be the result of a reflection carried out considering instruments mainly traded in larger markets. We are concerned about the application of these metrics for small markets and countries if their specific conditions are not taken into account. Additionally, we are also concerned about the possibility that, in order to maintain a uniform definition of liquid assets, the EBA may decide not to classify as liquid those assets which are liquid in certain jurisdictions but not in others. There has to be certainty that the chosen method appropriately reflects the mechanisms and specificities of national markets when considering LCR eligibility given that the uniformity of the metrics could be detrimental by ruling out assets that may result to be liquid in their national markets. A consequence of that would be the decrease in the demand of the assets not traded in liquid markets triggering a fall on their asset price.

We welcome the fact that there are no plans to force financial institutions to use the liquidity metrics put forward by the EBA in its envisaged empirical analysis. The criteria present in the list are largely based on the available current data which is, indeed, extremely limited when it comes to exchange-traded securities. Hence, banks would either be incapable of meeting such a requirement or compliance would be excessively costly.

In our view, there should not be any obligation for banks to use the liquidity metrics in order to carry out an independent review verifying that the liquidity classification is up-to-date. Any such single-handed analysis obligation for banks would not only result in excessive costs for banks themselves but it would also be inefficient from an economic point of view and create considerable competitive distortion.

Generally speaking, the liquidity-based categorisation of securities should be simple and transparent. Notwithstanding the foregoing, in order to ensure a uniform categorisation, we would welcome the ISIN list (including haircuts) which indeed has been ruled out by the EBA. Potentially, the EBA could delegate the task of drafting such an ISIN list and regularly updating it to the central banks. Indeed, central banks already publish similar lists (for instance the ECB's file of eligible collateral). However, the ISIN list in order to improve efficiency should not be exhaustive.

Furthermore, we are not certain that all the factors presented in the Discussion Paper are appropriate to judge market liquidity. As an example a wider bid-ask spread may not be a negative aspect if it helps to create a market for certain securities. We also have doubts on the concept "Remaining time to maturity".

Moreover, we believe that the additional factors presented to judge covered bonds are more restrictive than those presented for Residential mortgage-backed security (RMBSs). We believe that the regulated market and the special legislation of covered bonds should grant a better treatment in comparison to RMBSs. It should be considered whether reducing the number of factors for identifying market liquidity to a few would make the implementation more feasible for the banks.

Regarding the Equity data in the chapter Data on Asset Classes, it is planned to confine the analysis to equities listed in the main national index in each jurisdiction, but it should not be implied that only these equities could be considered as liquid assets excluding other equities listed in Stock Exchanges.

We have also some comments to provide on the EBA's decision to restrict their analysis to assets issued in EU currencies. This approach would not take into account assets issued, for example, in USD, possibly the world's reserve currency, which among other things play a key role in repo markets. The same might be true for CEE/SEE, MENA and Asian currencies, which global, international banks should be incentivised to hold for the sake of diversification and sound risk management. This has the potential for overlooking or under-estimating the liquidity of non-EU asset classes. Additionally, limiting the scope to EU-denominated assets may not be consistent with the goal of pursuing global regulatory harmonisation and a level playing field.

Should the scope of the analysis not be extended (e.g. covering CEE/SEE) the gathering of the necessary data to define criteria and thresholds independently by an institution will be a main issue. Furthermore, detailed guidance on how to perform the analysis in a comparable way is needed. It should also be made clear that qualifying liquid assets in the trading book are part of HQLA. After all, they could be assessed in a liquidity crisis the same way than any other HQLA in the banking book.

2. **Answers and reflections on the questions posed:**

Q1. Given the difficulties with obtaining transactional data outlined here, do you think a data sample cover 2008-2012 is sufficient for this analysis? Would you see merit in extending the sample in those countries where more data is available?

Although we consider that the data sample covering 2008 – 2012 should be sufficient for the initial analysis, we would like that it be taken into account that the sample from these years includes the crisis period and therefore liquidity may look weaker than in a business as usual scenario. Additionally, when it comes to subsequent updating, both the need to know how the instruments behave under turbulent periods and the appropriateness to include new types of assets, which may be developed as a result of banks' need for more liquid instruments, must be taken into account.

Q2. Do you have additional data sources to suggest? Specifically, can you suggest a source of repo data and gold that would fit our needs?

The use of MIFID data as a transaction based data for debt securities seems reasonable. Additionally, another data source for debt securities could be the data from third party providers which frequently receive trade information from market participants. This could be for instance clearing agents (LCH, Clearstream, BoNY, ...) or a third party data provider like Bloomberg or mark-it.

Q3. Do you agree with the list of liquidity metrics under consideration to be used in the EBA assessment, as mentioned in this section and Annex 5? Can you suggest further metrics the EBA should make use of, where information would be available?

The precise calibration of the acceptable perimeters for these metrics must be approached carefully in order to avoid a result that eliminates many assets which are fundamentally considered liquid in the market, but fail to meet a 'litmus test' of metric compatibility. The EBA should therefore consider whether all criteria mentioned in the list is required to be met and whether all criteria should have the same weighting. As an example it could be questioned whether the regulatory framework (and in particular the liquidity framework) should give external credit ratings the same weighting as other factors. Many European economies have strong companies with an excellent credit and issuance track record although they are not externally rated.

The elements on the list of liquidity metrics all seem to be relevant when assessing the liquidity of an instrument. However, some of the mechanisms are not quite clear such as the "Remaining time to maturity" (h) and "maximum bid-ask spread" (g). The text on page 14 refers to the fact that issuances with a shorter remaining time to maturity are, to a greater extent, "locked in", reducing liquidity. Against this approach it can be argued that in times of stress, investors tend to ask for shorter maturities, thereby increasing the demand for instruments which do not have too long left to mature, thus giving the instruments higher value to hold as part of the liquid buffer. So, there might be both a lower and an upper remaining time to maturity to consider. Concerning the wider bid-ask spread factor we think that this may not be a negative aspect if it helps to create a market for certain securities. Metrics which focus on bid ask differentials will be a useful indicator of asset liquidity for equities, but we question their value for other asset classes such as fixed income instruments.

Generally speaking, we are of the opinion that it would be convenient to ensure that the metrics are not "aggregated" in a way that some metrics effectively rule out instruments which are widely traded and highly liquid. This could happen to some instruments that, for example, as a result of widening spreads during turbulence may result in being ruled out. If this becomes the case, the method will result in adverse, or even pro-cyclical, effects.

Q4. Do you agree with the list of explanatory characteristics whose linkage to liquidity it is proposed to be tested in the EBA assessment? Can you suggest further characteristics the EBA should assess?

In general, we believe that a greater emphasis should be placed on the exogenous 'characteristics' as opposed to the metrics listed in Annex five. These characteristics are given due regard, as a matter of convention, in most institutions own liquidity risk management processes. Furthermore, the characteristics do not risk including any data selection bias and are reliable indicators for asset liquidity on an ongoing basis (whereas metrics are only useful for point in time assessments).

The two lists of "general explanatory characteristics" contain relevant factors to consider. In particular we have the following comments:

- The formulation "Presence of a large number of market makers" tends to be naturally interpreted as a "minimum requirement". Such a requirement would rule out a large number of instruments. Furthermore, there is no certainty about the fact that the presence of a large number of market makers in "stable times" necessarily implies that they will stand ready to ensure that the instruments are also liquid under turbulence.

- The formulation "Trade via additional platforms and markets" will of course give a higher probability of selling an instrument in a catastrophic situation. However, it is not obvious that the liquidity of the instrument generally is enhanced by spreading the trade over more than one market. For many instruments, the opposite effect will be more likely.

- When it comes to "remaining time to maturity", please see the answer to Q3 above.
- We think that it would be convenient to include other factors such as eligibility as collateral for the ECB financing operations, or if the asset is granted by a Member State. Although we understand that it may be problematic due to the incentives for governments to back financial institutions in trouble, we consider that a half-way solution would be appropriate and should be put forward; perhaps taking into account a limitation on the issuance date in order to allow already issued instruments to be reported but not newly issued ones, so that the incentive for governments to guarantee bank debt to ensure their liquidity will disappear and will not exacerbate the loop between the sovereigns and banks, as the Presidency argued.

Q5. Do you agree with the methodology proposed? Do you have alternative approaches that might be used?

When it comes to the use of the methods in "practice", as ground for identifying which instruments should be eligible for the LCR, we support the aim of establishing a regime that ensures that instruments being found not eligible are not more liquid than instruments being found eligible. Nevertheless we think that this should be complemented with some national discretion. We also think that it is of crucial importance to strongly link the central bank eligibility to the liquidity value, i.e. to consider credit claims in the definition of highly-liquid assets. Lastly, we consider that "the lists" should be per currency or national market.

About WSBI-ESBG (European Savings Banks Group)

WSBI-ESBG – The European Voice of Savings and Retail Banking

WSBI-ESBG (European Savings Banks Group) is an international banking association that represents one of the largest European retail banking networks, comprising of approximately one-third of the retail banking market in Europe, with total assets of over €7,631 billion, non-bank deposits of €3,500 billion and non-bank loans of €4,200 billion (31 December 2011). It represents the interests of its members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects.

WSBI-ESBG members are typically savings and retail banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their region. WSBI-ESBG member banks have reinvested responsibly in their region for many decades and are a distinct benchmark for corporate social responsibility activities throughout Europe and the world.

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