POSITION PAPER

ESBG Response to

CEBS consultation paper on liquidity buffers and survival periods

(CP 28)

European Savings Banks Group Register ID 8765978796-80

October 2009

ESBG

The European Savings Banks Group (ESBG) welcomes the opportunity to comment on CEBS Consultation Paper on liquidity buffers and survival periods.

I. Introduction

ESBG would like to welcome **the principles-based character of CEBS guidelines**. A detailed rules-based approach providing concrete indication of the composition of liquidity buffers would disregard the fact that liquidity risk is institution-specific and business models and liquidity management are very diverse across institutions.

ESBG would like to point out that – according to our knowledge – there are only few types of securities that would observe the requirements set out in Guideline 4 on eligible assets for the liquidity buffer. This is likely to result in an increased demand for such securities that may eventually lead to disruptions in the securities markets. Therefore, we suggest that CEBS not only broadly considers the economic implications of its recommendations on the institutions and the economy (paragraph 18), but also that it undertakes **an impact assessment before the entry into force of these guidelines, in view of identifying and assessing potential negative effects on securities markets**.

ESBG firmly supports the indication of **proportionality as an overarching principle** (paragraphs 13, 34). This is particularly important for smaller banks that have a conservative business policy and low risk appetite.

As a principle, a **risk-based approach** to the management of liquidity risk appears to us appropriate.

II. Guideline 2 – Stress scenarios

ESBG **generally supports the proposed approach for stress scenarios**. However, in our view, this 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 the relevant empirical data. Moreover, in ESBG's view, several specific aspects should be further addressed as indicated below.

According to Guideline 2, institutions should apply three types of stress scenarios (idiosyncratic, market specific and a combination of the two). It is important that idiosyncratic scenarios be not simply added to market specific scenarios, as there are many interactions. We consider that the use of **idiosyncratic scenarios** on the basis of the current financial market crisis represents already a combined stress scenario.

Given the direct link between the size of the liquidity buffer and the results of the conducted stress scenarios it is of utmost importance, in ESBG's view, that the supervisory authorities develop a **common understanding as regards the appropriate design of stress scenarios** in view of avoiding competitive distortions. This is particularly relevant for the market specific stress scenarios (paragraph 39).

ESBG would also like to underline that **market specific stress scenarios are relevant mainly for institutions that refinance themselves on the capital markets**. From the perspective of the proportionality principle, it needs to be clarified that it is expected mainly from capital-market oriented institutions to apply market specific scenarios. The same reasoning also applies to combined stress scenarios.

III. Guideline 3 – Survival period

As regards the time horizons, we consider it appropriate to have **two phases** as proposed, a short acute phase of stress followed by a longer period of less acute but more persistent stress. It should be clearly specified whether the acute short period is included in the moderate longer stress period.

IV. Guideline 4 – Composition of the buffer

ESBG takes the view that **a too narrow definition of the assets eligible for the liquidity buffer should be avoided**.

In our view it is the **central bank eligibility of an asset which should be the decisive and single criterion**, as banks rely on the fact that they can use central bank eligible assets for their funding needs.

Requiring that the assets composing the liquidity buffer be **additionally "highly liquid in private markets" is in our view not appropriate**. It will lead to the fact that at least parts of the refinancing capacity of banks will not be able to count for the purposes of the liquidity buffer. This would lead to a distorted reflection of the liquidity position of an institution. Furthermore, we wonder which are the objective criteria allowing to establish that assets are highly liquid in private markets. This is a particularly relevant question if we consider that central bank eligibility is already substantially linked to marketability criteria, including market liquidity. Therefore, we suggest deleting the requirement that an asset be considered highly liquid in private markets.

It would be also welcomed to clarify the meaning of central bank measures falling under the concept of "**emergency facilities**" (paragraph 58).

According to paragraph 59, banks will be required to **test periodically whether central banks will effectively provide funding** against eligible assets as collateral under stressed conditions. Given that such collateral often consists of portfolios of assets it would be welcomed to have more indications about how to conceive such tests on central bank eligibility.

Furthermore, 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". We understand CEBS concerns from the perspective of the role of central banks as "lender of last resort". However, we would suggest that it be clarified that **the regular participation in open market operations should not be interpreted as a close dependence of central banks**. ESBG would welcome the development of criteria that would indicate a strong reliance on central bank facilities.

V. Guideline 5 – Diversification of assets

ESBG agrees that the diversification of the assets that constitute the liquidity buffer is very important. As regards the requirement to avoid holding large concentrations of single securities applied to central bank eligible assets, there should be **no additional concentration limits apart from those established by the central banks themselves for the acceptance of assets as eligible collateral**.

From a regulatory perspective, the diversification requirement should not oblige banks to acquire assets with longer maturities or to conclude operations in a foreign currency. The composition of the liquidity buffer should rather take into account the specific liquidity risks of individual banks as regards their maturity structure and the currencies held.

The requirement in paragraph 64 that **firms should seek to be active on a regular basis in each market in which they hold assets for liquidity purposes is particularly burdensome** for small and retail-oriented banks and would involve very high transaction costs. Therefore, ESBG suggests that this requirement be explicitly linked to the **proportionality principle**.

VI. Annex – Cash flows and counterbalancing capacity

ESBG suggests that, when determining the funding needs, relevant known cash flows such as issuances, significant asset sales etc should be taken into account.

In our view, the proposed **differentiation between contractual and behavioural cash flows** does not bring more knowledge about the liquidity situation, nor would it be reasonable to be applied in the case of retail banks with sound deposits.

About ESBG (European Savings Banks Group)

ESBG (European Savings Banks Group) is an international banking association that represents one of the largest European retail banking networks, comprising about one third of the retail banking market in Europe, with total assets of € 5967 billion (1 January 2008). It represents the interest of its Members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects.

ESBG Members are typically savings and retail banks or associations thereof. They are often organized in decentralized networks and offer their services throughout their region. ESBG Member banks have reinvested responsibly in their region for many decades and are one distinct benchmark for corporate social responsibility activities throughout Europe and the world.

European Savings Banks Group - aisbl
Rue Marie-Thérèse, 11 ■ B-1000 Brussels ■ Tel: +32 2 211 11 11 ■ Fax : +32 2 211 11 99

Info@savings-banks.eu ■ www.esbg.eu

Published by ESBG. October 2009