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Finance for Europe

Association for Financial Markets in Europe

Consultation Paper Response

Draft Implementing Technical Standards Amending Implementing Technical Standards on Supervisory Reporting on the Liquidity Coverage Ratio (EBA/CP/2014/45)

10 February 2015

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the EBA's recent consultation paper on Draft Implementing Technical Standards Amending Implementing Technical Standards on Supervisory Reporting on the Liquidity Coverage Ratio ('LCR'). AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

We set-out below our response to the consultation paper, and as an overarching comment we would like to highlight the importance that the EBA allows sufficient time to reflect on the comments it receives from firms and to engage meaningfully with industry before it makes proposals to the European Commission.

In terms of timings[1], we note that the EBA is proposing a first reference date of no earlier than December 2015 and that firms will continue to report on the LCR using the existing templates until this time. The LCR Delegated Act will, however, apply from October and the current templates may not allow a meaningful reporting of the new standard. We understand from the EBA's Public Hearing that it is likely to be left to national supervisors therefore to obtain information on firms' compliance with the LCR until the revised reporting templates come into effect. AFME and its

[1] EBA Consultation Paper, Question 3 'Do respondents agree with the implementation period suggested?'

members strongly urge the EBA to work with the European Commission and national regulators to find a common and consistent reporting solution and to ensure that firms are not required to report data which is redundant or potentially misleading. Such an anomaly should not be allowed to exist because of procedural inertia.

In the meantime, AFME has noted previously[2] that the current ITS on reporting has required banks to move from a 30-day remittance period to a 15-day remittance period for LCR reporting from the end of January. It is extremely challenging for banks to meet a 15 day timeline without having completed full systems implementation. However, full implementation based on rules and templates that are changing is clearly inefficient from a resource perspective and firms would request that sufficient time is allowed to fully develop their internal control processes based on the final version of the EBA templates. It would seem appropriate instead that the 30-day remittance period should continue to apply at least until the minimum LCR comes into force on 1 October.

As a further point, we would highlight also at this stage the importance of the treatment of foreign exchange flows. In particular, the clarifying example for the treatment of FX flows, in section 5.2 of the consultation paper is potentially very damaging for banks which are large FX market makers and the EBA should reconsider its interpretation of Article 21 of the Delegated Act. We set out further background to this important issue as part of our more detailed analysis below.

Reporting Treatments and Instructions[3]

We set-out below specific instances where we feel material uncertainty still remains, and where more detailed and/or updated technical instructions would be likely to result in more consistent reporting across the industry. This should also in time facilitate more meaningful engagement with supervisors. We include also as an appendix two questions that we have previously submitted to the EBA through the Q&A process and as part of follow-up correspondence where we feel that further work is needed.

Treatment of Foreign Exchange Flows

The treatment of FX derivatives on a single currency basis coupled with the application of an LCR by currency is extremely punitive and could have very severe unintended consequences for the FX market globally.

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[2] AFME letter to Delphine Reymondon of 16th October 2014

[3] EBA Consultation Paper, Questions 4 and 5 'Do respondents agree to the structure and content of the proposed new LCR templates added for credit institutions? Particularly comments from respondents on specific rows, columns or any other item would be very valuable and appreciated including comments on the treatment of secured transactions.' and 'Do respondents find the new LCR instructions for credit institutions clear? Particularly comments from respondents on specific rows, columns or any other item would be very valuable and appreciated.'

By way of illustration, if a bank swaps EUR 100 for USD 150, maturing within 30 days, a USD LCR by currency will show a USD 150 outflow and no corresponding inflow. This treatment assumes within the LCR stress scenario, that the FX markets close in full for 30 days, which would be unprecedented and very unrealistic. During the 2008 crisis, FX markets remained fully operational. For a short period of time, there was heightened friction within the market but never at extreme levels (e.g. the widest USD/EUR spread observed during 2008 was 2%).

We appreciate that regulators need to monitor a bank's liquidity risk profile in certain material currencies. If strict thresholds on an LCR by currency are applied however (e.g. 80-100%), the treatment of FX flows as proposed within the CP would make an LCR by currency extremely punitive. Banks would be left with no choice but to minimize the volume of cross currency transactions, to be able to meet such a ratio. This would in turn have an impact on the quantity of services provided to the real economy.

Furthermore, it is our view that this treatment was not the intention of the BCBS, or the European Commission, when developing the LCR calculation; which focused on an all currency combined metric. We therefore question whether it was the EBA's intention to further develop this regulatory approach through the mechanism used within this consultation paper and urge the removal of the restriction on FX inflows.

Liabilities Resulting from Secured Lending and Capital Market Driven Transactions

Article 28(3) paragraph (g) of the Delegated Act references the application of a 100% outflow rate to liabilities resulting from secured lending and capital market driven transactions where they are collateralised by assets that would not qualify as assets in accordance with Title II. The reference to Title II, however, brings in Article 8 on operational requirements. This would not seem to be intentional as it would represent a marked and significant departure from the CRR text and the BCBS standard, and we would recommend therefore that it is clarified that the existing interpretation (i.e. excluding the requirements of Article 8) continue. We strongly urge the EBA to work with the European Commission and national regulators to clarify that such a policy change is not the intention of this provision.

Potential Double Counting of Forward Instruments

We would note that the BCBS guidance states that unsettled sales and purchases of HQLA can be ignored for the purposes of the LCR. If however the EBA intends to suggest the implementation of a diverging approach the following should be considered:

- There appears the potential for the double counting of forward instruments, thereby overstating the LCR, given the requirements to report Assets and Inflows in the Draft Annex XXV for Assets Part 1 and Part 3. In particular:

a) Part 1: Liquid Assets: - Paragraph 1.2.3.11 provides specific requirements for forward starting transactions.

   All assets complying with Article 7, 8 and 9 of the Delegated Act, which are in stock at the reference date, shall be reported in the relevant row in Template C72 even if they are sold or used in secured forward transactions.

b) Part 3: Inflows: - Paragraph 1.3.1 provides specific remarks for forward starting transactions.

   Credit institutions shall report inflows from transactions which have been contractually agreed but not yet settled at the reporting dater and which will imply an inflow in the 30-day horizon. These inflows shall be reported in {C 74.00; R260} ('other inflows'), gross of corresponding outflows, unless the transaction involves contracts listed in Annex II of Regulation 575/2013/EU (CRR).

Accordingly, the combined implementation on the above two paragraphs will mean that when a firm has entered a sell contract which has not yet settled, they will report the asset in Template C72 and recognise the cash inflow in template C74, thereby 'double counting'.

Whilst there is ambiguity in these instructions, we understand that the intention is not to double count flows and that firms should work on this basis.

Liquid Assets

- The provision of a more definitive list of Public Sector Entities eligible as Level 1 liquid assets in Article 10(1)(c) of the Delegated Act (row 090) and major stock indexes in Article 12 (1)(c)(i) (row 380) might lead to greater consistency in the application of the Delegated Act. For 'major stock indices' we suggest cross-referencing the ESMA ITS developed under Article 197(8) of the CRR.
- Industry would welcome clarity on the meaning of a 'central institution' in Article 16 of the Delegated Act and clarification on what the liquid assets template is referring to in row 450 in respect of 'deposit by a network member with a central institution'.
- Guidance on the calculation of cross currency SFTs would be appreciated. In particular:

  - at this stage, it is not clear whether reverse repos and tri-party trades are within the scope of the reporting requirements, and;
  - when margin is posted based on MTM and FX charges, whether institutions are intended to deduce the amount of capital based on actual FX charges or take into account the actual collateral posted. The former would of course be a hypothetical calculation while in the case of the latter, the calculation would not solely cover the cross-currency risk. It would be useful if the EBA could provide a worked example.

Outflows

- Clarification on the calculation of callable excess collateral (row 380) and due collateral (row 390) would be useful, particularly in regard to the treatment of collateral in transit which is being settled but is not due. By way of illustration, on day 0 there might be a MTM of 100 and collateral is also 100, so sleeper collateral is 0. Then on T+1, MTM changes to 10 but collateral will be settled only on T+2. It is not clear whether the 10 collateral in transit from T+1 to T+2 should be included in the calculation of sleeper collateral. Worked examples from the EBA would be welcome.

- The outflow reporting instructions are not fully aligned with the reporting template. For example, the row references from 1140 to 1380 in the reporting instructions are not aligned to Template 73 row references 1150 to 1420.

Collateral Swaps

- Confirmation that inflows and outflows can be populated on the same row, thereby confirming netting at a transactional level would be useful.
- Clarification from the EBA would also be helpful on the definition of collateralised derivatives (columns 090-120), together with clarity on how to report collateral swaps where the swap is for a security against a basket of securities.
- There appears to be an error in the C73 template which should be rectified. The number that is picked up from the C75 template for C73 Row 1130, Column 060 'Total outflows from collateral swaps' is the sum of all of the rows from I12 to I81 including sub-totals, whereas the number picked up from the C75 template for C74 Row 410, Columns 140,150, 160 'Total inflows from collateral swaps' is formed of columns J10, K10, L10 as appropriate. We believe that C73 should pick up I10 from the C75 template.
- The requirements for the collateralised derivatives disclosure required on the collateral swaps template are currently not clear. In particular, is this disclosure in respect of all non cash collateral given and received on derivative transactions or only such collateral linked to the derivatives in the 30 day period.

Collateralised Derivatives

- Clarification is sought from the EBA on how collateralised derivatives should be reported in template C75. For example, for a derivative liability (e.g. €100) that has been collateralised with Level 2A assets (e.g. €105), which row and column would this need to be reported in. More detailed instructions and examples would be useful.

SFT Asymmetry

- The illustrations contained on pages 19 and 20 of the consultation paper introduce the concept of asymmetry between the treatment of repo and reverse repo cashflows. We would like to seek clarification on what appears to be an additional haircut over and above the 75% inflow cap.

- In addition, different inflow and outflow factors are prescribed depending on whether the Level 2B equities meet the requirements of Title II, which includes operational requirements. As mentioned earlier, the inclusion of operational requirements would be a marked change from existing CRR text and BCBS requirements.

Additional Collateral Outflows – Use of the Historical Look Back Approach

- The EBA's approach to the use of the Historical Look Back Approach is capable of different interpretations and also differs from the BCBS standard. The interpretative issue hinges upon the understanding of the meaning of 'the largest difference in collateral posted within consecutive periods of 30 days during two preceding years'. It is not clear how the maximum and minimum should be defined in order to arrive at the largest difference, due to various references in the RTS on additional liquidity outflows due to collateral needs to both 'collateral posted' and 'cumulative flows'. Accordingly, it would be useful if the EBA could provide more detailed reporting instructions and worked examples to allow industry to discern more clearly the approaches and treatments that are intended.

  In the meantime, we would note that the HLBA as defined by the BCBS continues to apply, pending the completion of the Final Regulatory Technical Standard.

Application of the 90% Cap on Inflows

- We note that the updated reporting templates allow for the reporting of inflows subject to the lower outflow cap of 90% as provided for under the Delegated Act. We would note, however, that the industry is awaiting further more detailed guidance on the criteria which will need to be fulfilled to allow the application of the lower cap, and that this will need to be provided sufficiently in advance to facilitate accurate reporting.

Further Implementation Considerations

Additional Liquidity Monitoring Metrics

- We noted in the EBA's consultation on additional liquidity monitoring metrics that the EBA might consider the application date of these additional requirements in relation to the application date of other liquidity reporting requirements. AFME and its members would welcome such consideration, and we would suggest that the LCR reporting should be finalised and effective before additional templates are introduced. In particular, the reporting of additional liquidity reporting monitoring metrics might coincide with the completion of the LCR 6 month 30 day remittance period, in around mid-2016.

Association for Financial Markets in Europe
February 2015

Annex 1

As mentioned, AFME has previously submitted questions on the following areas both through the Q&A process and follow-up correspondence. We feel that further work remains to ensure a meaningful reporting of transactions and we remain available to engage with policymakers on these important topics.

Reporting Treatment of Forward Starting Trades

- AFME and its members submitted question 2013_380 to the EBA in October 2013, which noted that further clarification on the reporting of forward starting trades would be useful. In particular, we mentioned that a forward starting trade will have two cash flows, one at the start and one of the maturity of the trade.

  The question was answered in March but the response provided does not relate clearly to the question. In the meantime, the BCBS April FAQ document on the LCR provided very clear clarification on this topic under point 15 'Other cash flows' and we would suggest that this approach is adopted in Europe. We note that the answer to a subsequent question on forward starting trades, question 2014_784 could be read as suggesting an alignment to the BCBS' approach but further clarity is needed.

  More widely, under the guidance given in response to question 2013_380, forward starting trades to roll existing deposits would be penalised. For example, a bank might have a $100m deposit that matures in 3 days and as such this would be reported in the LCR calculation. If the counterparty requested a forward starting trade to roll this deposit for an additional 2 weeks, then based on the guidance, a $100m inflow would be reported as well as the additional $100m outflow. If inflows were capped then a $25m requirement would arise, despite the lengthening of the deposit actually being beneficial from a liquidity risk perspective.

  In addition, under the guidance provided, short positions covered by reverse repos that mature within 30 days would be required to be reported separately which may result in a requirement should the inflow cap be applied. We would recommend instead that the treatment should be aligned with that set out in the BCBS template (under cash inflows: 'reverse repo and other secured lending or securities borrowing transactions maturing <30 days of which collateral is re-used in transactions to cover the reporting institution's outright short positions'), where a 0% weighting is applied and therefore no liquid assets requirement will arise.

Inclusion of Transactions between Trade and Settlement Dates

- AFME submitted question 2013_378 to the EBA in October 2013, where we noted that firms typically apply a contractual approach to the measurement of liquidity which for

transactions between trade and settlement dates would result in inflows and outflows being grossed up and subject to the 75% inflow cap. By way of example, we noted that a bank might enter a trade to purchase a $100m bond from counterparty A, with settlement at T+3. The bank then enters into an additional trade to sell the same bond to counterparty B with settlement also occurring at T+3. Both cash flows would occur on day 3 and net to zero and the balance sheet position would be zero. We noted, however, that if the inflows and outflows were reported separately, then the 75% inflow cap could apply.

The EBA responded to the question in April, stating that each transaction should be seen as a separate transaction in the context of the LCR and that the inflows in our example might therefore be subject to the 75% cap. The application of the cap to such trades would have a substantial impact on brokerage and market making businesses and would be likely to significantly and unmeaningfully skew the LCR for firms engaged in these activities.

We feel that the treatment described in the answer to question 2013_378 is inappropriate also given that payments made to exchanges are made on a net cash flow basis. For example, if a bank has $100m of shorts and longs settled on the same day, no payment would be made. However, the EBA's guidance could result in the bank having a $25m liquid assets requirement owing to the application of the inflow cap.