4th December 2013

Dear Mr. Ettl,

As EBA finalises its reports to the European Commission, we urge you to consider a number of important issues. We refer specifically to the EBA’s reports on uniform definitions of liquid assets and on the economic impact of the liquidity coverage requirement, which the EBA is tasked with preparing by 31 December 2013 and by 31 January 2014 respectively, pursuant to Article 509 of the CRR.

**Impact of the LCR**

In assessing the potential broad impact of the LCR on financial institutions, markets, stability and growth, we would like to emphasise the importance of the following elements:

a. **The role of the exceptional monetary policy measures (LTRO) in assessing any LCR shortfall:**

   We are concerned that the present EU banks’ LCR shortfall might be underestimated if exceptional monetary policy measures (LTRO) are not taken into account. European banks are likely to suffer a very significant shortfall once such measures are phased out. In AFME’s view, this highlights the need to include central bank committed liquidity facilities, as analyzed by the ECB, in the liquidity buffer (with appropriate calibration, notably in terms of pricing).

b. **Potential areas of super-equivalence to the BCBS framework:**

   We note the important developments in the updated Basel liquidity framework in January and we would suggest that to the extent relevant these should be taken into account by the EBA in its report. Some of the substantive areas of change which the EBA should incorporate include allowing equities in the liquidity buffer, and lower outflow rates for off balance sheet items. We would also take the opportunity to highlight our concerns around calculation methods that we understand EBA, in its draft standards, is considering and which are more stringent than in Basel III, e.g. with regards to the **run-off rate applied to retail clients deposits**.

In relation to **operational requirements for the holding of liquid assets**, Art. 509(5c) in the CRR tasks the EBA with reporting to the Commission on this subject, and on its alignment with international regulatory developments. In line with the Basel text (BCBS 238, paragraphs 32 & 33), we believe that firms should be able to include assets in the liquid assets buffer that they can indicate that their Treasury or other central function can monetise throughout the 30 day stress period without directly conflicting with a stated business or risk management strategy. The BCBS text offers a helpful example in this respect in that the sale of an asset which is being used as a hedge should not result in an open position that breaches risk limits. We note that the main aim of the CRR in this area is to ensure that ‘liquid assets are subject to appropriate internal arrangements to ensure that they are available to the treasury when needed’.

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1 40% for liquidity facilities granted to banking institutions and other financial counterparties such as insurance groups, and 30% for credit lines granted to companies.
We believe, therefore, that the reference to the use of liquid assets in ‘other ongoing operations, including: (i) hedging or other trading strategies provides an example of when an asset might not be readily available. However, if an asset happens to serve as a hedge but is readily available, it should be eligible for inclusion in the buffer. This is consistent with Basel III. In our view, it is important that the EBA report to the European Commission clarifies that – in line with Basel III – assets used for hedging or other trading strategies can count towards the liquid asset buffer, so long as they are readily available to the treasury function when needed. The EBA may wish to consider recommending to the Commission a clarification of this aspect, in the context of its delegated act.

Finally, whereas the Basel Committee proposals are applied on a consolidated basis, in the CRR the LCR would apply to individual entities, which significantly toughens LCR requirements. While the provision of a waiver process is envisaged in some instances so that groups or sub-groups might report their liquidity on a consolidated or sub-consolidated basis, the starting position for regulated firms is to report liquidity metrics on an entity by entity basis. The impact of this requirement will be particularly burdensome for firms until a waiver is granted, or for those entities for which only partial waivers are available, and is likely to result in the preparation and submission of very large volumes of returns.

c. Stress factors applied in the LCR outflow calculations to margin calls on derivative products:

We understand that the EBA intends to select the worst-case stress scenario for each derivative portfolio, assuming a shock for each risk factor (primarily interest rate, currency, equity and credit). Derivative portfolios cannot be dissociated from their underlying assets and should follow consistent stress assumptions. A worst case scenario where margin calls are maximised may correspond to a market wide increase in share prices, while the stress scenario for the underlying assets in the LCR supposes an illiquid market. These two scenarios could not co-exist as increasing share prices would of course allow a firm to divest holdings of any particular stock and its derivatives more easily. We suggest therefore the application of a single and coherent stress scenario across both derivative products and their underlying assets.

Definition of liquid assets and high quality securitisations

Many acknowledge the important role high quality securitisation has to play in restoring European growth. AFME and its members are very concerned that the EBA is moving towards an inappropriate treatment of high quality securitisation which will hinder prospects for revival of this market in both the near and medium term. Steps have been taken by regulators and the industry to address the shortcomings of the past. The regulatory approach needs to be balanced, sensibly calibrated and evidence-based.

We ask that the EBA includes “high quality” securitisations as HQLA within the LCR, distinguishing them from other forms of securitisation which performed poorly during the crisis.

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2 Notably senior policymakers including Commissioner Barnier, President Draghi and (more recently) Governor Carney of the Bank of England and Yves Mersch of the ECB.
The above concerns and recommendations are explained more in detail in the attached note.

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In the context of the ongoing constructive engagement with EBA, we would welcome and appreciate any further opportunity to discuss these important issues.

Yours sincerely,

Simon Lewis,
Chief Executive Officer, AFME