4th December 2013

Dear Andrea,

Further to my recent letter dated 27th November 2013 setting out the feedback and concerns of AFME's member firms regarding the important current EBA work on the future of securitisation markets, I am writing now to draw to your attention a number of additional key issues, in the context of the EBA's ongoing crucial work on the reports on uniform definitions of liquid assets and on the economic impact of the liquidity coverage requirement.

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[1]. 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'. We believe, therefore, that the reference to the use of liquid assets in 'other on-

[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.

going 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 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.

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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