



*European Association of Co-operative Banks
Groupement Européen des Banques Coopératives
Europäische Vereinigung der Genossenschaftsbanken*

**Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2**

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CH-4002 Basel

E-mail: baselcommittee@bis.org

Consultative Document: "Principles for Sound Liquidity Risk Management and Supervision"

Dear Sir or Madam,

The European Association of Cooperative Banks (EACB)¹ welcomes the opportunity to comment on CEBS's orientations on the specific elements of its technical advice on Liquidity Risk Management.

This matter is of crucial importance for many of our member organisations. Please find below our answer to your Consultation paper. We are available at any time for more detailed comments on the matter in question.

Yours sincerely,

Hervé Guider
General Manager

Volker Heegemann
Head of Legal Department

¹ The **European Association of Co-operative Banks** (EACB) is the voice of co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 members and co-operative banks in general. With 60,000 outlets and 4,500 banks, co-operative banks – which are privately owned entities- are widely represented throughout the enlarged European Union and play a major role in the financial and economic system. In Europe, one out of two banks is a co-operative. Co-operative banks have a long tradition in serving 140 million customers, mainly consumers, retailers and SMEs. Quantitatively, co-operative banks in Europe represent 47 millions members, 730,000 employees with a total average market share of about 20%. For further details, please visit www.eurocoopbanks.coop



I. General Remarks

A. Flexibility

The members of the EACB welcome the BCBS Draft "Principles for Sound Liquidity Risk Management and Supervision." This will improve the document from February 2000 and help banks to develop improved standards for the management of their liquidity risk.

Regulation regarding liquidity risk management differs between jurisdictions. This variety indicates that even different approaches to the matter will lead to satisfying results.

Moreover, in most jurisdictions regulation for liquidity risk management is relatively "open" and allows banks to develop their own models. In fact, only a very principle-based approach will allow to properly reflect the wide variety of business- and risk-management-models, as well as a timely adjustment to changing market conditions.

From our perspective, it is therefore highly important that the new Basel principles remain "open" and flexible and give sophisticated international banks as well as smaller and non-complex institutions room to develop their own management systems for liquidity risk, while ensuring a certain minimum standard. Such "openness" and flexibility are also a precondition for further technical progress: The suggested principles should allow, possibly even encourage banks to further develop and improve their systems.

Therefore, it will be highly important that supervisors do not take a narrow approach to the document and demand the fulfillment of the principles and the accompanying text by the letter. To the contrary, there has to be a "comply or explain (your alternative solution) - approach", which allows banks and supervisors to discuss the matter.

This however, seems to be difficult, where the explanatory text becomes highly descriptive, as is the case, for example regarding intraday risk management positions (principle 8).

B. Proportionality

In Nr. 6 it is stated that the paper focusses on medium and large complex banks, while underlining that the principles should have broad applicability to all banks and that implementation should be tailored to the size and nature of business and complexity of a bank's activities. The members of the EACB fully support this "proportionality" element. We regret however, that these reflections are not enshrined in one of the principles and that it is clearly stated that a bank's liquidity risk management-system should properly reflect the size and complexity of the bank and its business and that any measures from supervisors should not go beyond that as well.

As pointed out above, we insist on the opportunity for smaller banks to establish their own tailor-made liquidity risk management systems for their banks, if they



so wish. Simplified standardized requirements should only be a kind of fall-back option, an offer, but not a must.

We therefore urge the BCBS to introduce in principle 1 a sentence that the application of the following principles and the measures to be taken by supervisors should properly reflect the size and the complexity of the business and the structure of the relevant bank.

In fact, the application of some of the more detailed guidance, e.g. regarding “transfer pricing” in principle 4, (quantification of the liquidity cost for all significant business activities) could be overly burdensome. The same applies to the design of stress-tests.

The text should allow that national authorities design a set of “more simplified standard rules for smaller banks”, comparable to the standardized approach for solvency management under Basel II, keeping in mind that especially in co-operative or mutual banking-groups, group wide liquidity reserve systems are working successfully.

II. Specific Aspects

A. Principle 3: Review of strategy, policies and practices related to liquidity risk management by the Board of directors.

The experts of the EACB wonder whether a board of directors can really execute such a far-reaching review by itself. Such task would also go far beyond what is required for other types of risk (e.g. solvency). We wonder whether it would not be more realistic that the Board of Directors ensures, verifies and takes the responsibility that senior management has carefully executed such a review.

Furthermore, smaller banks, due to limited resources, will have problems to ensure operational independence in control functions.

B. Principle 4: Transfer-Pricing

The wording suggests that banks are obliged to include liquidity cost in their pricing.

We doubt that it would make sense for smaller, non-complex banks, to calculate liquidity cost by product. Such requirement would be far too burdensome, especially because the paper does not take into account the different ways of refinancing (savings account versus capital markets).

However, we would like to strongly underline that the determination of the price of a product to the customer is in the decision authority of the bank and that supervisors should oblige banks to definitely include it in their pricing. But certainly we agree that complex banks should be able to establish liquidity cost on a per-product-basis and thus be able to include liquidity cost into their product pricing.



C. Principle 6: Management of Liquidity across business lines

As regards this element, we equally doubt that it should relate to smaller, non-complex banks.

Furthermore, we think that for complex banks the only aim should be to “treat together what belongs together” and that therefore banks should be free to define their business-lines.

In our view the key point is that the liquidity management of a banking group disposes of procedures, methods and an organisation that is appropriate to its business and structure and that redundancies and unnecessary administrative burdens are avoided.

D. Principle 7: Funding strategy

It is suggested that a bank should limit concentration on any one funding source. In retail banking this will not be possible. In particular, recent events have shown that retail deposits are a relatively stable form of funding. A limitation of deposits would have a significant impact and would reduce stability.

Furthermore it has to be pointed out, however, that in many decentralised non-consolidating co-operative banking-groups, local banks often channel the funding through their (sectoral) central banks. This is normally complemented by specific guarantee schemes for co-operative banks, which in the past have more than once proven their merits.

For bigger banks and the (sectoral) central banks we can agree with the proposed objective of broadening the funding base.

E. Principle 8: Management of Intraday Liquidity under both normal and stressed conditions.

While Payment- and Settlement Systems may be considered within a more general context, it has to be pointed out that risks stemming from such systems are primarily managed as operational risks. Therefore heavy conditions that could imply a duplication of supervision have to be avoided.

The stress-testing of the intraday processes and systems would be very difficult and costly. While stress-situations should certainly be considered, we wonder whether intra-day systems should be really be subject to systematic stress-tests.

Furthermore, we doubt that the described requirement could be fulfilled by smaller, non-complex banks. For such banks, a daily monitoring and evaluation of liquidity data should be sufficient.

F. Principle 10: Stress-Testing

The definition of the parameters of the stress-test is finally the decisive element for the quality of liquidity management. While we accept that stress-scenarios should be “severe” and that severe scenarios should not be discounted as



“implausible”, we would nevertheless wish to underline that it will be important not to go too far and to keep the right balance between what could be one out of many unexpected traumatic developments and the precautions that a bank can meet to handle such developments.

In particular “combined” scenarios could lead to a ban of a certain combination of business activities and create a strong danger for profits.

As for smaller banks, it will be important that they do not have to build their stress-scenarios themselves, but probably use certain “standard scenarios” suggested by supervisors, associations or external consultants.

F: Principle 13: Public disclosure

The publication of any data regarding a bank’s liquidity management is highly sensitive on one hand. The disclosure of data on the liquidity management and the liquidity position could give (too) much of an insight, also to competitors. On the other hand we see the aim of supervisors to develop a tool that could help to build the confidence of market-participants.

On the other hand it has to be avoided that disclosure of information on liquidity management and the liquidity position becomes an end in itself: The liquidity position of a bank is extremely fast-moving and may change considerably even during a single day. Therefore causes for a misunderstanding or misinterpretation by the public have to be avoided.

For this reasons we think that expectations regarding this aspect should not be too high, but realistic.

For further information or questions on this paper, please contact Mr Volker Heegemann, Head of Department (v.heegemann@eurocoopbanks.coop)