ZENTRALER KREDITAUSSCHUSS

MITGLIEDER: BUNDESVERBAND DER DEUTSCHEN VOLKSBANKEN UND RAIFFEISENBANKEN E.V. BERLIN - BUNDESVERBAND DEUTSCHER BANKEN E.V. BERLIN
BUNDESVERBAND ÖFFENTLICHER BANKEN DEUTSCHLANDS E.V. BERLIN - DEUTSCHER SPARKASSEN- UND GIROVERBAND E.V. BERLIN-BONN
VERBAND DEUTSCHER PFANDBRIEFBANKEN E.V. BERLIN

10117 Berlin, 16. April 2010
Charlottenstraße 47
Tel.: 030/20225-5334
Fax.: 030/20225-250
Kä
ZKA-Az: BASEL

Secretariat of
Basel Committee on Banking Supervision
c/o Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel

Switzerland

Consultative document "International framework for liquidity risk measurement, standards and monitoring"

Dear Sir or Madam,

we[1] thank you for the opportunity to comment on the Committee's consultative paper "International framework for liquidity risk measurement, standards and monitoring". Please find our contribution enclosed herewith. We would appreciate it if our comments were taken into consideration in the Committee's further deliberations.

On behalf of

ZENTRALER KREDITAUSSCHUSS
Deutscher Sparkassen- und Giroverband

Hartmut Kämpfer   Dr. Silvio Andrae

---

[1] The Zentraler Kreditausschuss (ZKA) is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR) for the cooperative banks, the Bundesverband deutscher Banken (BdB) for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB) for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV) for the savings banks financial group, and the Verband deutscher Pfandbriefbanken (VdP) for mortgage banks. Collectively, they represent more than 2,300 banks.

Z E N T R A L E R   K R E D I T A U S S C H U S S
MITGLIEDER: BUNDESVERBAND DER DEUTSCHEN VOLKSBANKEN UND RAIFFEISENBANKEN E.V. BERLIN • BUNDESVERBAND DEUTSCHER BANKEN E.V. BERLIN
BUNDESVERBAND ÖFFENTLICHER BANKEN DEUTSCHLANDS E.V. BERLIN • DEUTSCHER SPARKASSEN- UND GIROVERBAND E.V. BERLIN-BONN
VERBAND DEUTSCHER PFANDBRIEFBANKEN E.V. BERLIN

Zentraler Kreditausschuss
Position Paper
on the Consultative Document of the Basel Committee
"International framework for liquidity risk measurement, standards and monitoring"

Ref.: Basel

16. April 2010

I. General observations

In principle, we welcome the Basel Committee's intention to modernise the prudential treatment of the liquidity risk and to standardise it internationally. However, in our view, the proposed liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) require substantial amendment.

The conceptual structure and the underlying conservative assumptions to calculate the prudential ratios will have adverse effects on the business activity of the institutions. The new prudential requirements would force the institutions to make massive changes to their balance-sheet structure. This concerns both sides of the balance sheet.

On the assets side, especially on the basis of the LCR, the institutions would be obliged to hold large stocks of highly liquid assets, especially in the form of government bonds and in central bank accounts. The price for the security of these investments would be an only modest rate of interest, so the required liquidity reserve would have massive repercussions in terms of yield reduction in the profit and loss account of the institutions. The increased demand for government bonds would lead to their prices rising and yields falling further, which would further reinforce the effect. Apart from that, it should be clarified whether the supply of government bonds in issue is sufficient at all to meet the demand to be expected. At the same time, the corresponding funds could no longer be used for corporate credit facilities.

Alongside the market for government bonds, covered bonds represent the second largest segment in the global bond market. The global covered bond market (including the USA and Canada) totalled just under EUR 2,500 billion at the end of 2009. Of this, German *Pfandbriefe* accounted for EUR 719 billion (approximately 30%). In particular against the background of the guarantee mechanisms enshrined in law, the German *Pfandbriefe* represent a long established, reliable instrument for investment liquidity and risk diversification.

Hitherto, a substantial proportion of institutions' bonds have been held in other institutions. Through the proposed extensive non-consideration of bank bonds under the LCR (liquidity reserve), the capital market demand for these instruments would fall. Institutions would have to attach higher coupons to their bonds in order still to be able to attract any investors at all. This would further increase the funding costs of the institutions. The longer maturities necessary to comply with the NSFR on the liabilities side would increase the institutions' funding costs still further.

Although the processes just described concern first and foremost institutions which fund to a large extent via the wholesale market, there will nevertheless be second-round effects on all institutions with a business model focusing on retail business. On account of the comparatively favourable ASF factors for retail deposits under the NSFR, we assume that the competition for retail deposits will increase considerably – with the corresponding consequences for the margins obtainable from business with private customers.

In this connection, it should also be considered, however, that not all banks engage in the deposit business. The business models of the *Pfandbriefbanken*, for example, as well as of the State development banks, provide for funding essentially through the issue of *Pfandbriefe* or State-guaranteed bank bonds respectively. Accordingly, these banks would not even have the possibility of mitigating the effects of the NSFR by extending their retail business.

This shows that, apart from the effects on the earnings situation of the institutions, entire business models would be called into question. This is true for institutions whose main focus so far has been on either wholesale funding or retail funding. Like the capital requirements, the regulatory requirements on liquidity risk management should be neutral in relation to the respective business model. In this respect, the ratios call for a thorough review to restore this neutrality.

In addition to the effects on credit institutions, we also expect massive economic distortions. Institutions' borrowings would be far less available than before for lending, since they would have to be invested to a not inconsiderable extent in highly liquid assets to satisfy the LCR. At the same time, with the NSFR, the capacity of the banks to undertake maturity transformation – one of the essential economic functions of the banks – would be considerably restricted. It is questionable whether, how and by whom this service is to be provided in the future. The borrowing real economy would come under pressure not only through the lending policy which the institutions would be forced to conduct by the regulations. Also firms which fund directly on the capital market would experience problems in finding buyers for the bonds they issue because credit institutions, which hitherto have purchased corporate bonds, would have to invest their funds to a greater extent in government bonds and central bank assets (crowding out).

Finally, the risk of a system crisis would increase, since all institutions would be bound by the regulatory specifications to aligned action. As a result of too narrow a definition of the authorised high quality liquid assets for the LCR, the institutions would furthermore incur concentration risks induced by the regulations. The accompanying lack of diversification would increase the systemic risk further.

Furthermore, we point out that the proposed regulations are to be applied exclusively to institutions. This increases the likelihood of reactions of switching to transactions with other sectors of the financial industry which are not subject to the Basel Committee regulations.

With regard to the scope of application (point 133), we point out that the implementation of the new proposals in the institutions must be based on the principle of double proportionality. Furthermore, the Consultative Document provides in some places that national supervisors may adopt more far-reaching provisions. This gives rise to two problems: on the one hand, especially institutions which operate internationally would find themselves facing different requirements and, on the other hand, the different application of the legislation in different States would make it more difficult to analyse the effects of the new regulations. Therefore any adaptation of the legislation should be coordinated at international level in advance.

Moreover, the ZKA criticises the scheduling of the Basel Committee. The deadline for consultation on the paper presented ends on 16 April 2010, whereas the quantitative impact study (QIS) ends only on 30 April 2010. As a result, it is not possible for the credit industry to substantiate the requests it puts forward in quantitative terms. Furthermore, the extremely tight-packed schedule of the QIS gives rise to the concern that the figures to be supplied to the Committee cannot be of the urgently necessary, appropriate quality. This is particularly hazardous in view of the considerable impact of the new regulations.

The QIS deadline should therefore be extended. Its results should serve to enter the discussion without preconceived conclusions on the correct amount of the imputation factors and other quantitative specifications. We consider validation by a new QIS to be absolutely essential.

Particular attention should be paid here to the effects of the planned simultaneous entry into force of the large number of aspects to be tightened up by the regulations on which consultation is currently taking place. It is impossible to estimate the associated cumulative effects at present. In our opinion, this situation fundamentally will not change when the results of the QIS are available. In particular, the simultaneous entry into force of the measures in the Basel Consultative Document “Strengthening the resilience of the banking sector” and the measures which are the subject of the consultation here will undoubtedly give rise to considerable distortions. The ZKA therefore expressly advocates compiling individual packages of measures from the total package of impending measures and deferring their implementation with intervals of at least one year between the individual packages. In this way, the real effects of the individual packages could first be observed. In addition, it would also be easier for the supervisors to readjust if undesirable developments are observed.

Big banks in many cases offer services (settlement of payment transactions, supply of liquidity) for smaller institutions which often do not have their own access to the capital market. The corresponding deposits of the smaller banks have proved to be very stable because precisely during the crisis, suppliers of services must ensure that specific accounts are kept in credit, on the one hand, and the smaller banks often deposit funds with institutions with which business relations have existed for many years, on the other. Often these business relations are accompanied by participating interests between institutions. It would therefore be appropriate not to assess the corresponding deposits in the same way as normal interbank deposits. Rather, where the funds cannot be withdrawn in the short term for operational reasons (e.g. payment transactions still have to be settled during crises too), distinctly smaller run-off factors are to be assumed.

Furthermore, we should like to support banks being authorised to use internal procedures for liquidity risk measurement and management as an alternative to the prudential ratios proposed by the Basel Committee for assessing the adequacy of the liquidity cover (opening clause). The use of internal procedures in prudential treatment, especially of market and credit risks, has rightly become increasingly important in the past few decades. In the field of the liquidity risk too, through the use of internal procedures, particularities in the business models of the banks could be taken into consideration more effectively and the ensuing individual risks be better identified than through a standard approach. Suitable qualitative and quantitative minimum requirements for the use of such procedures should be drawn up together with the banks. This would lead to further enhancement of the quality of the liquidity risk management.

The proposal of the Basel Committee furthermore assumes that banks must ensure their liquidity even in the case of stress without exposures to the central banks. The underlying assumption that central banks make no liquidity at all available in such a case is unjustifiable. Already in normal times, commercial banks can obtain liquidity from the central banks by means of a variety of instruments. The current crisis has shown that central banks have even made additional liquidity available to the market in such times. Certainly, the banks should not assume in their planning that the central banks will make additional facilities available in a crisis. However, it can at least be assumed that in such a situation they do not restrict the funding possibilities of the banks. Accordingly, beyond the assets recognised by the Basel Committee, it should be permitted to impute assets which are recognised as collateral by the respective central bank. The inclusion in the liquidity reserve should be allowed to the extent that liquidity can be generated from this collateral under normal conditions from the central bank. This should also include assets not eligible for trading in the market such as claims on debtors of high credit standing. Another argument in favour of the use of the eligibility for rediscount with the central bank as a qualification criterion is that this is more objective than marketability.

In this connection, the Basel Committee should also express its view of the future role of the central banks under normal market conditions and under stress.

We welcome full transparency towards the respective supervisors. However, we do not consider the planned publication of data in the context of the prudential **disclosure** to be appropriate. Information on the liquidity position of an institution is particularly sensitive. On the one hand, banks could be driven into a kind of competition to over-fulfil the minimum requirements, even though the minimum ratios guarantee cover of stress cases. On the other hand, market participants could withdraw deposits from such banks at which the ratios are only slightly above the minimum requirements. This could give rise to a self-fulfilling prophecy, which would lead to deterioration in the bank's liquidity situation. Already the reduction of an over-fulfilled ratio could give rise to clear, inappropriate market reactions. The disclosure of the absolute level of the liquidity reserve would therefore compromise their useability. We therefore expressly advocate publication being required in the context of disclosure only of whether or not an institution has complied with the prudential ratios. This is already practised at present in some jurisdictions.

Finally, we should like to refer to the interactions of the LCR with the leverage ratio proposed in the Basel Consultative Document "Strengthening the resilience of the banking sector". The current configuration would cause the institutions to have to retain additional assets on the assets side of the balance sheet to comply with the LCR. As a result, however, their leverage ratio would automatically deteriorate. This in turn could lead to other assets having to be reduced, with the consequence that the scope for lending of the institutions would lessen. We therefore consider it appropriate that "high quality liquid assets" eligible for consideration in the context of the LCR are <u>not</u> to be considered in the calculation of the leverage ratio.

Last but not least, in the view of the banks it would be extremely desirable for the various regulatory efforts to limit the liquidity risks, which are currently under discussion within various bodies, were to be harmonised and coordinated. This would reduce both the complexity of liquidity management and the necessary reporting effort.

General observations on the LCR

We view especially critically the obvious preferential treatment of government securities in the composition of the liquidity reserve to determine the **liquidity coverage ratio**. Focusing solely on high quality government securities would impair the possibilities of private undertakings to fund on the capital market and would weaken the earnings situation of the banks. This would in particular lead to increasing the expense of corporate financing.

Furthermore, the Basel Committee seems to be of the view that there can be no risk in connection with high quality government bonds. In the past, however, at times of crisis, sometimes significant widening of spreads could also be observed in the case of government bonds. In our opinion, it is therefore necessary as

a matter of urgency, for this reason too, to allow the banks to hold a widely diversified liquidity reserve. For this purpose, it is necessary to extend the range of assets which may be included in the liquidity reserve considerably.

The liquidity equalisation between banks on an anonymous, collateralised basis via stable, organised repo markets with a high turnover can make a major contribution to mitigating the systemic risk. This too is successful only if the banks hold a relatively large volume of assets which are suitable for these markets. Too narrow a definition of the assets qualifying for the prudential liquidity reserve could prove counterproductive in this respect.

State-guaranteed bank bonds represent an important funding instrument for credit institutions and are held in large volumes by credit institutions. They are not inferior to other State-guaranteed bonds in terms of liquidity. Therefore they should be admitted in full as components of the liquidity reserve.

Covered bonds, especially *Pfandbriefe in Germany*, represent a traditional funding instrument of the Pfandbrief banks. With a volume of *Pfandbriefe* amounting to some three quarters of a trillion euros in issue, the Pfandbrief market is one of the largest segments of the European bond market. Even during the acute phase of the financial market crisis, in contrast to other sources of funding, neither the primary nor the secondary Pfandbrief market failed. It is true that the issue volumes were lower, but issuing activity was consistently maintained. Against this background, these instruments should be eligible without restriction as components of the liquidity reserve.

Unsecured bank bonds are not to be permitted to be included in the liquidity reserve. We reject this as inappropriate. Holding bank bonds enables further diversification by institutions of both their borrower default and market risks. This possibility to diversify would be massively undermined if bank bonds were no longer to be eligible for the liquidity reserve. In our opinion, unsecured bank bonds entail a comparable risk to unsecured corporate bonds and should therefore be treated in the same way. We see no economic justification to discriminate against bank bonds in relation to other corporate bonds. Not least, it should be borne in mind that in reality a significant proportion of the funding of the institutions takes place via bank bonds. Their importance is set to increase further in the future on account of the strict specifications of the NSFR.

We can understand that changes in the market value of securities included in the liquidity buffer should be monitored during the holding period to ensure their intrinsic value. Nevertheless if the criteria – and especially those in relation to credit quality and market liquidity – had to be met at all times, this would have the consequence that certain bonds, in the case of a temporary loss of confidence in relation to this borrower, would not be included in the liquidity reserve any more. This in turn would lead to a deterioration

in the convertibility into cash of these securities, since all banks would try simultaneously to sell them. Ultimately, the prudential requirements would have the effect of exacerbating the crisis as the Bank for International Settlements found in its Working Paper No 293.[1] We therefore advocate for an appropriate provision.

The stress scenario proposed for the LCR as a combination of institutional and market-specific shocks is in our opinion excessively conservative. In this, individual results which were to be observed at different several banks during the two years of the financial crisis are aggregated into a cumulative stress event lasting 30-days which never occurred in this way. We therefore call on the Basel Committee to justify the combined stress scenario and to illustrate it with examples.

Furthermore, in our view, the run-off rates for funds which were made available to the institutions, assumed in the context of the LCR, seem excessively high. They were not observed at this level even during the financial crisis. Here too, we call on the Basel Committee to provide empirical support for the rates chosen.

General observations on the NSFR

The **net stable funding ratio** in the configuration proposed would lead to banks having to fund their long-term credit business to a large extent with matching maturities. This would mean that banks would be less able to perform their important economic function of maturity transformation. Furthermore, it is highly questionable whether the capital market would be in a position to absorb the volumes of long-term bank bonds necessary for this. This is particularly true if (as proposed) these papers may not be included in the liquidity reserve for the purposes of the LCR. This reduced attractiveness of bank bonds could be offset only by clear return surcharges. This gives rise to the risk of a restriction or a clear increase in the cost of long-term lending for lack of funding facilities with matching maturities. Possibly these effects will also lead to liquidity transformation to a greater extent in unregulated sectors of the economy.

Furthermore, in the context of the NSFR, more realistic assumptions should be made concerning the extensions of funds which were made available to banks with a residual maturity of less than one year, which are consistent with the assumptions in the context of the LCR. This means that in the case of funds for which no run-off is assumed in the context of the LCR, it is to be assumed that these are also available in the longer term as funding for the purposes of the NSFR. In addition, the imputation rates for assets with a remaining maturity of over one year should be consistent with the assumptions of the LCR. Assets for

[1] Borio, Claudio (2009): Ten propositions about liquidity crises, BIS Working Paper No 293, p. 9.

which under the LCR convertibility into cash within the 30-day horizon is assumed should no longer also be covered under the NSFR by stable funding resources.

In principle the proposed factors both for the available stable funding (numerator) and the required stable funding (denominator) are excessively conservative. The Basel Committee should present empirical evidence for this too.

II. Regulatory Standards

II.1 Liquidity Coverage Ratio

Point 21: As we interpret it, the Consultative Document does not make any clear statement concerning the assessment basis to be chosen to determine the ratio (e.g. current market value, book value, etc). We request clarification.

Points 22 & 23: We reject the stress scenario proposed by the supervisors as excessive. In the Committee's opinion (Point 23), several events which occurred during the two years of the financial crisis are to be amalgamated in a single scenario. In our opinion, however, this even extends well beyond what was to be observed after the insolvency of Lehman Brothers. For such a crisis to appear in a period of just 30 days seems unrealistic to us. Against the background of the experience of the financial crisis, the institutions are currently working under high pressure to improve their liquidity situation. We therefore assume that such a stressed liquidity situation as in this financial crisis will not be repeated.

Point 24: The stress test described in Point 22 is to establish only a minimum requirement for the banks. According to the Basel Committee's proposals, the banks are also to conduct their own stress tests to establish whether they should hold additional liquidity beyond the level specified in the LCR. In this connection, we should like to point out that the institutions are also required according to the Basel "Principles for sound liquidity risk management and supervision" to carry out their own stress tests in the field of the liquidity risk. These specifications were transposed in the EU under Pillar 2. To avoid confusion between Pillar 2 and the regulatory measures on which consultation is taking place here, it should be clarified on the one hand that the values determined in the context of the supervisory review process must not be used to determine the liquidity reserve in accordance with the LCR. At the same time, conversely, it should be clarified that the Basel Consultative Document lays down no requirements regarding the liquidity stress test in accordance with Pillar 2.

A. Stock of high quality liquid assets

Point 26: The stringent provisions for assets eligible for inclusion in the liquidity reserve will probably result in institutions to a large extent having to restructure within the liquidity reserve in low-margin assets. As a result, the Basel Committee not only assumes influence over the liquidity maintenance of the institutions, but also massively over their earnings situation which will deteriorate dramatically.

Point 33: In our view, it should not be imposed on institutions to comply with the LCR in each significant currency. It is true that the institution should be in a position to satisfy its liquidity needs in each currency and also to hold highly liquid assets to the extent to which different currencies are to be considered. The appropriate distribution of the currencies among the assets to be reserved should however continue to be left to the institution and only monitored through supervision.

Point 34(b): We support the proposal of the Basel Committee made in footnote 8 that local supervisors and relevant central banks should discuss the treatment of central bank reserves. We share the view that in times of crisis the total amount of the central bank reserves (i.e. including the minimum reserve) is to be counted as liquidity reserve.

Point 34(c): With regard to our fundamental criticism of the restriction of the “high quality liquid assets”, we refer to our general observations. In particular, we assume that securities issued by regional and local territorial authorities are also to be subsumed under this point.

Point 34(c)(iii): The inclusion of bank bonds in the liquidity reserve is not to be allowed even if they are guaranteed by a public authority. This discrimination against State-guaranteed bank bonds compared to other State-guaranteed bonds is incomprehensible in our view. State-guaranteed bank bonds have a comparable risk profile to government bonds and high liquidity. If they comply with the conditions set out in point (c),(i) and (ii), their unlimited inclusion in the liquidity reserve should be permitted.

On account of their limited business field and a comprehensive guarantee (*Gewährträgerhaftung*) of the Federal Republic of Germany or of a state (*Bundesland*), in our opinion, it should be permitted to include especially bonds of State development institutions in the liquidity reserve. These banks act on behalf of the State and their objective is not to maximise profits. Claims on these institutions therefore represent a risk comparable to that of their owners. This is shown both by the low risk premiums of these instruments and by their treatment in the field of solvency supervision. In that context, the risk weighting of their owners can be taken over for claims on development banks under the standardized credit risk approach. Accordingly, the development institutions themselves had no funding difficulties of any kind during the financial crisis.

According to point 34(d), it is permitted to include government bonds in the currency in which the liquidity risk was taken or in the bank’s home country currency in the liquidity reserve without further conditions. In our opinion, it should be clarified that this also includes bonds issued by regional governments and local authorities if their risk does not differ from that of the central government on account of institutional arrangements.

Point 35: The Basel Committee is currently examining whether and to what extent corporate bonds and covered bonds may be included in the liquidity reserve. We expressly support the inclusion of these instruments. In particular, German ***Pfandbriefe***, on account of the strict legal provisions and the quality of the cover pool, offer outstanding security which is no less than that of government bonds. We therefore expressly advocate the extension of the liquidity reserve to include covered bonds and *Pfandbriefe*.

Focusing only on high quality government bonds would have the further adverse effects outlined above on the funding possibilities of the private sector and on the earnings situation of the banks.

According to the ideas of the Basel Committee, corporate bonds and covered bank bonds are not permitted to comprise more than 50% of the liquidity reserve. This restriction appears arbitrary in our view. Since by implication, at least 50% of the liquidity reserve must consist of cash or government bonds, it could moreover lead to banks no longer being in a position to diversify their liquidity reserve to a sufficient extent. The 50% limit should therefore be abandoned.

Points 36 and 37: In our opinion, unsecured bank bonds possess comparable risk characteristics to unsecured bonds issued by corporates outside the financial sector. The financial crisis has shown that the bilateral repo markets for these bonds worked. For this reason, these instruments should be considered under the same conditions as corporate bonds in the liquidity reserve. The full exclusion of bank bonds from the liquidity reserve foreseen by the Basel Committee would in our view lead to institutions with short-term liquidity surpluses no longer being in a position to transfer these to institutions seeking long-term liquidity. This would in turn have a negative impact on the liquidity situation of the institutions.

The ZKA recognises that the inclusion of these bonds could artificially inflate interbank liquidity if institutions hold such bonds reciprocally. Furthermore, in the event of a banking crisis, they should show a higher correlation with the general market risk (wrong-way risk). However, the measures currently under discussion to improve the solvency and liquidity situation of the institutions make it less likely that these securities are no longer tradable in the event of crisis. Furthermore, large exposure provisions apply in the EU which further reduce the concentration risk in the interbank market.

Moreover, we consider the criteria proposed for the inclusion of corporate bonds and covered bonds to be impracticable with regard to the characteristics of the markets on which these bonds are traded (Points 36 and 37, 4th and 5th bullets). The requirement that instruments must be traded in a large, deep and active market characterised by a low level of "concentration" is not operational. The required 10-year data history for bid-ask spreads would also probably exist only in very few cases. This also applies to the required data histories with regard to the negative market value fluctuations. It would be totally disproportionate if the instruments were to remain excluded from the liquidity reserve until the desired data history had been achieved. For the above-mentioned reasons, the rating of the issuer and the central bank eligibility of the instrument represent the decisive criteria for inclusion of these bonds in the liquidity reserve.

As already described, on account of the strict legal requirements, German *Pfandbriefe* have such a high credit standing and therefore market liquidity that the proposed 20% haircut appears inappropriate. *Pfandbriefe* with a rating of at least AA should accordingly be permitted for inclusion in the liquidity reserve without a haircut. Furthermore, in the cases of these financial instruments the banks should also be allowed to hold their own issues in the liquidity reserve.

In principle we can understand that changes in the value of securities included in the liquidity buffer should be monitored during the holding period to ensure their intrinsic value. However, an infringement of the qualification criteria in the course of time on account of a temporary loss of confidence in relation to a borrower would have the consequence of increased pressure to sell the corresponding instrument which could have the effect of aggravating the crisis. Therefore a regulation should be drawn up that takes due account of both aspects.

To reduce the high procedural expenditure in the institutions, the supervisors could publish a list of authorised securities. Such a list would on the one hand provide clarity for the institutions with regard to papers which could be included in the liquidity reserve. On the other hand, it could ensure that no distortions of competition arise through different classifications. However, the list should not be definitive.

Point 37: In order to further improve the diversification of the liquidity reserve, in our opinion equity and precious metals, especially gold, should be eligible for the liquidity reserve. It emerged during the crisis that gold in particular not only rose in value but was also tradable, so that it could be used for the procurement of liquidity. In this respect, such assets too should be eligible. Their greater volatility could be taken into account by haircuts.

<u>B. Net cash outflows</u>

Point 38: In principle, the cash outflows which, in the view of the Basel Committee, the banks are to assume when determining the liquidity coverage ratio appear to us to be unrealistically high. This is also true against the background of the experience obtained during the financial market crisis. <u>We therefore call on the Basel Committee to justify the proposed rates.</u> At the proposed amount, the regulations would result in a considerable increase in the banks' funding costs and these costs would have to be passed on to customers. At the same time, the quantity of credit granted would be reduced.

Point 41: Retail deposits are to be divided between "stable" and "less stable" deposits. A "stable" deposit is to be assumed, inter alia, when the customer has other established relationships with the bank which make deposit withdrawal highly unlikely and the deposits are in transactional accounts. We consider this division to be arbitrary and on account of the criteria selected for differentiation, it would lead to very high additional technical and organisational effort. Institutions with more extensive retail business would be forced to evaluate thousands of customer connections individually for each notification. As long as no empirical evidence of the need for such differentiation is presented by the Committee, this should be relinquished and retail deposits should be subject to a uniform 7.5% run-off factor. A run-off factor of 15% is incomprehensible especially in the case of savings deposits in view of the experience during the financial crisis.

The requirement that the deposits must be held for transactional purposes to be considered as a stable source of funding excludes savings deposits – one of the most stable sources of funding of all. Withdrawals from savings accounts at ATMs are only possible to a limited extent – if at all – and in cases of stress banks will pay out to a customer only the part of the savings deposit for which notice has been given. In this respect, the proportion of the funds which can be withdrawn at short notice can be treated as a stable retail deposit. Funds beyond this can be withdrawn by a customer only after the period of notice has expired. These should therefore be considered as not due under the LCR and likewise as stable retail deposits under the NSFR.

Point 46: Funding resources which are callable within 30 days are to be considered in the liquidity run-offs (with corresponding run-off factors). In this respect, however, no consideration is given to the side on which the right to give notice exists. Since banks will only give notice if they have sufficient liquidity available to make the repayment, only rights to give notice on the part of the investor should be considered here.

Point 48: With regard to the distinction between "stable" and "less stable" deposits of smaller business customers, we refer to our comments on retail deposits. The observations made there on the assumed run-offs to be applied to retail deposits apply mutatis mutandis. Furthermore, to distinguish these customers, the banks are to consider not only the annual turnover but also the aggregated liabilities of the bank to the

customer. This distinction too would give rise to very considerable technical and organisational effort. To be able to undertake a correct classification of current or savings accounts of this customer group in the corresponding reporting category, the bank would have to assess the total liabilities in relation to each individual customer for the purposes of the liquidity reporting.

Points 51 to 53: Liabilities to non-financial customers are to be subject to a 25% run-off factor only if substantial services are provided for the customers. These services may consist above all in the bank undertaking the customer's cash management. The qualitative standards for the cash management are to be laid down by the Basel Committee. This consequently means that the institutions are responsible for the verification of customer's cash management. Since no standard solutions have been foreseen for this purpose, the institution would have to undertake an expensive case-by-case examination. This requirement is simply unacceptable for institutions and is rejected.

Point 54: If no significant services are provided to non-financial corporate customers, the run-off factor is raised to 75%. On this subject, we should first like to point out that the distinction between the two above-mentioned groups is also not justified from the risk point of view, since corporate customers to which no significant services are provided react far less sensitively to a crisis in the banking system than banks, for example. Furthermore, the distinction between the two groups would require a great deal of technical and organisational effort. A uniform run-off factor of 25% should therefore be assigned.

Point 55: Institutions are to assume that in the stress scenario, 100% of the funds made available by other institutions will be withdrawn. This assumption seems unrealistic to us. The risk of a withdrawal should in our view be differenciated bycertain groups of financial institutions, e.g. banks, for which the specific services (in particular: clearing, liquidity procurement) are provided (see our general observations on page 5). Such deposits tend to react more like retail deposits and should therefore be treated accordingly.

It is also striking that provision has been made for asymmetric treatment of funds which were made available to a bank by another bank, on the one hand, and credit lines made available to the bank by another bank,on the other. Whereas for the former it is assumed that the deposits are redeemed in full, in the case of the latter it is assumed that in addition committed credit facilities of other banks can no longer be drawn down. Since the Basel provisions are regularly applied at consolidated level, it is to be assumed that only deposits or credit facilities of banks outside the group are considered. In our opinion, it is only for such configurations that this very conservative approach can be justified (in so far as the run-off factors we are calling for are applied). However, if it were to come to application at the level of the legal entities too, asymmetric treatment would create an incentive to reduce liquidity support within the group. For these internal group transactions, it would be correct in our view to assume a withdrawal of the deposits by other institutions belonging to the group according to the factors we have proposed. On the other hand, it should

be assumed that credit facilities made available by other institutions belonging to the group can be drawn down in full.

Point 56: All debt securities which cannot be assigned to any other category are to be assigned to the category "*Unsecured wholesale funding provided by other legal entity customers*". It is not clear here how, in the case of bearer securities, it is possible to prove that they are held by private investors or non-banks.

Point 58: In the case of short-term secured transactions used for funding a bank and maturing within the 30-day horizon (e.g. securities repurchase or lending transactions), it is to be assumed that only the transactions referred to in point 34(c) and (d) relating to securities issued or guaranteed by public sector entities can be extended. For all other transactions, it is to be assumed that no extension of the transaction is possible. We reject this assumption as being excessively restrictive. Furthermore, it discriminates regarding assets which on the basis of their identical or nearly identical credit quality are authorised to be included in the liquidity reserve. It should therefore be assumed that all securities repurchase and lending transactions can be extended which relate to assets which the institutions are authorised to include in their liquidity reserve.

Point 65: We consider the proposed assumption that no issue of covered bonds is possible beyond the 30-day period to be inappropriate in the case of *Pfandbriefe*. Through this, the quality of the Pfandbrief is put on a par with ABS and other structured financing and the potential to issue *Pfandbriefe* even in a difficult market environment is not given appropriate consideration. Even in the financial crisis, it was possible, through on-tap issues, to raise financial resources regularly in the capital market. The ZKA can show, on the basis of a survey available to it, that during the entire financial crisis (between January 2007 and December 2009) *Pfandbriefe* were issued continuously. *Pfandbriefe* were issued weekly in volumes of between EUR 6.8 billion and 21 billion per month. The 100% run-off factor is therefore in no way justified. Accordingly *Pfandbriefe* should be subject to a far lower run-off factor.

Point 66: The definition of **irrevocable credit facilities** and liquidity facilities should be explained in more detail by the Committee. "Credit facilities" are usual in the financing of corporate customers, which can be drawn down for various purposes and via different products. In case of need, these lines can also be used to bridge over maturing issues as the designated use is open. This one possible use (of many) should not however lead, in the case of the later implementation of the new liquidity requirements, to it being obligatory to classify the credit facilities as irrevocable liquidity facilities. In this respect, a precise demarcation is necessary. Moreover, the past crisis has shown that committed credit facilities extended to corporate customers are not drawn down substantially more. This was even the case of corporate customers who were hard hit by the effects of the crisis and at which an issue matured during the crisis. These corporate customers were able to place a new issue on the market even during the crisis without calling on the committed credit facilities. In addition, corporate customers usually fund long-term. We consider the

planned 100% factor to be far too high. We therefore suggest reviewing this parameter on the basis of empirical data.

ABCP programmes are liable to be disadvantaged in the prudential treatment by the LCR and NSFR, which focus on maturities within one month and within one year respectively. According to point 609 of the Basel Framework Agreement, the Internal Assessment Approach (IAA) may be applied to calculate the capital cover for such exposures precisely only for securitisation exposures with which primary instruments with a maturity of up to one year are issued. If this is not the case, and on account of the lack of knowledge concerning the underlying portfolio, the Supervisory Formula Approach also cannot be used, the positions concerned must be deducted in full from the capital, since external ratings for a large number of exposures are extremely expensive or simply impossible. Accordingly, the banks are forced by the requirements described above to limit the maturity of the instruments issued under the ABCP programmes they sponsor to at most one year. The treatment of ABCP proposed by the Basel Committee would particularly affect medium-sized enterprises which fund via such programmes. The run-off factors for the corresponding CP under the LCR and NSFR should therefore be reduced considerably or the requirement to use the IAA in the context of ABCP programmes should be relaxed accordingly.

Points 64 and 66d: When considering liquidity run-offs arising from **conduit business**, the institutions are to assume that they cannot fund 100% of the ABCP maturing within the 30-day horizon by issuing new CP. Such a high factor was not necessary even in the subprime crisis. It should therefore be assumed that only 75% of the maturing CP cannot be funded by issuing new CP.

With regard to the factor for committed liquidity facilities to conduits, we request clarification that only commitments which have so far not yet been funded (either via the market or the bank) are to be included. Double counting would result if all maturing funding of the bank had to be included and at the same time the bank would be subject to deduction of the full committed facilities.

Point 66 a, b: Credit facilities extended to retail customers and non-financial corporate customers are to be subject only to a 10% factor. In our opinion, this rate should also be applied to committed credit facilities extended to the public authorities. Such facilities (apart from the US public finance business) were not drawn down more frequently in the financial market crisis than previously. If it has been contractually agreed between the bank and the borrower that on drawing down the credit facility in full, the institution makes available assets which can be considered as highly liquid assets under the LCR covering the full amount of the drawdown, no factor should be applied.

Point 66 c, d: Credit and liquidity facilities only have to be imputed if they are not repayable at any time. In this case, they are in principle to be imputed at 100% of the committed amount. This relates above all to

facilities which were made available to other financial institutions. In our opinion, this factor is set far too high. In our experience, the drawdown amounts to just under 20%. If a higher factor were to be set, banks would also have to be allowed to the corresponding extent to include credit facilities made available by other banks as liquidity inflow. It is currently assumed there that the bank is in no way in a position to use contractually committed credit facilities.

Point 69: The factors for other contingent funding obligations are to be established by the national banking supervisors. According to point 69, first bullet, “unconditionally revocable “uncommitted” credit and liquidity facilities” are to be included. In our opinion, in the case of such facilities there is no risk of them being drawn in the case of stress against the will of the bank. Therefore, according to Point 60, they are also not to be included under the liquidity coverage ratio. In our opinion, imputation should be renounced in full. Otherwise, the obligation to reserve liquidity for such facilities would cause a distinct rise in the costs of current accounts and payment products.

Point 70: Furthermore, according to the proposals, all other liquidity outflows are to be captured, in so far as they were laid down by contract (e.g. interest and principal due). On this subject, we should first like to point out that in the case of deposits due, a certain extension rate should be assumed so not all repayments due have to be considered. Interest due, on account of its secondary importance in the context of the LCR, should not be imputed.

Point 71: Institutions are to be permitted to consider cash inflows from exposures which are fully performing. It should first be clarified here what is meant by “fully performing”. If this definition does not correspond to the other definitions used in the bank, the determination could give rise to higher administrative expenditure for the bank.

Point 75: This regulation could be interpreted to mean that reverse repos involving highly liquid assets are unjustifiably disadvantaged. The liquidity is available to the institution at all times. Either the exposures are not extended and the liquidity flows back to the institution or the institution can convert the loaned securities into cash. We therefore assume that the collateral can be considered as liquidity reserve in the context of the LCR.

It is to be assumed that the banks are no longer able to draw contractually committed credit facilities in the case of stress (Point 76). In our view, this is not a realistic assumption. Even at the height of the financial market crisis, interbank liquidity could be generated to a certain extent on the money market.

Committed credit facilities purchased by banks may not be included as effective in terms of liquidity in the new standard. This would mean that the committed credit facilities lose their function as liquidity risk

mitigation instrument. Mitigation of the liquidity risk through liquid assets would lead to a balance sheet extension.

Furthermore, in our opinion, further payment inflows (inflows from cash and securities, term deposits booked to assets and securities maturing within the 30-day horizon) should be eligible. In this connection, it should also be examined to what extent stochastic payment inflows, e.g. from rollover credit facilities, are eligible.

II.2 Net Stable Funding ratio

Point 82: For the purpose of NSFR calculation covered bonds and securitisations issued by banks are no longer considered as Available Stable Funding if their maturity falls below one year. We deem this treatment inappropriate. For the issuing bank, notably a *Pfandbrief* constitutes stable funding until it is due. Owing to specific legislation a redemption before maturity is excluded.

Point 83: The structure of the NSFR is based on a firm-specific stress scenario for a period of one year. This seems inappropriate to us, since considered over such a long period, the banks would be in a position to react to such stress with an adjustment of the business model. The NSFR should therefore in our view merely ensure that the bank funds the normal conduct of business to the required extent from stable sources.

Point 84: We can understand the approach adopted by the Basel Committee to wish to ensure the funding of institutions at the first stage without participation by the central banks. This seems appropriate in terms of prudence, especially as this refers to the individual institution. From our point of view, however, it is unrealistic to assume that in the case of a system crisis the central banks should not be used. They have been assigned this function as lender of last resort.

Point 86: In principle, the factors to be attached to certain liabilities positions with a residual maturity of less than one year, for the purposes of determining the available stable funding, should be consistent with the assumptions on the withdrawal of these funding components under the LCR. In our opinion, it can be assumed that at least the financial resources which would not be withdrawn even in the context of the acute stress scenario under the LCR, are available to the institution in the longer term.

In the case of retail deposits and deposits of small business customers, a distinction is to be drawn between “stable” and “less stable” deposits. The same criteria are to be used for the demarcation which are used for the liquidity coverage ratio. In this connection, we refer to the criticism we formulated there concerning the additional technical and organisational effort entailed in this distinction. Furthermore, as already stated, the

ASF factors of the NSFR should be consistent with the run-off factors under the LCR. Since with reference to the LCR, we call for a uniform run-off factor of 7.5% for the deposits in question, under the NSFR it should be assumed that 92.5% of the retail deposits and deposits of small business customers are available to the banks as stable sources of funding also for a period of over one year. Accordingly, a single ASF factor of 92.5% should apply for all the various deposits.

In addition, the ASF factor for funding components made available by corporate customers seems to us to be excessively conservative. Consistently with the single run-off rate of 25% which we called for in the field of the LCR, it should be possible for such liabilities to be assigned an ASF factor of 75%.

Liabilities which are not expressly allocated a lower ASF factor may not be counted as sources of available stable funding. These include first and foremost liabilities to other financial institutions. This seems entirely inappropriate. As in the case of the run-off factors in the field of the LCR, a differentiation should also be made here between different groups of institutions (see our comments on Point 55).

It should be possible to apply an ASF factor of 75% to funds made available by other financial institutions (e.g. capital investment companies or insurance undertakings).

It should be possible to consider only **own issues**, with no rights to give notice which could reduce the maturity to less than one year, as stable funding with an ASF factor of 100%. This is very conservative. If the issuer holds a right to give notice, full imputation should be allowed. It should moreover be examined whether issues with a creditor right to give notice are not better represented on the basis of the expected maturity. Furthermore, we refer to the fact that only a small portion of the implied options are exercised at all. We therefore advocate that funding with an implicit option carries an ACF factor of 85%.

As regards to the RSF factors complete funding should be provided for purchased covered bonds as soon as the maturity falls below one year. This provision is deemed to be inappropriate with regard to a German *Pfandbrief*. *Pfandbriefe* are assets of high quality as well as of high liquidity - both features were overserved in the course of the financial crisis. We therefore recommend that the treatment of *Pfandbriefe* happens irrespective of maturity.

The same is true in view of securitisations. Owing to the proposed assumptions for prolongation of assets included in a securitisation pool, complete funding would be required even if the securitised assets are due within one year and thus are match the maturities. We advocate for an adequate treatment matching maturity funding and therefore propose a RSF factor of 0% for assets inside a securitisation pool.

Point 89: The RSF factors for marketable assets with a residual maturity of over one year should in our opinion be consistent with the assumptions used in the context of the LCR concerning the convertibility of these assets into cash. It can be assumed that in the period considered in the context of the NSFR of over one year, at least as large a percentage of these assets can be converted into cash as within the acute stress period of 30 days.

Unencumbered marketable securities of government issuers with a residual maturity of one year or more, which may be included in the liquidity reserve in accordance with Point 34 c), are to be 5% covered by long-term stable funding. This is in contradiction with the assumption of the Basel Committee for the purposes of the LCR that the above-mentioned securities can be sold at any time and without loss of value. The securities should therefore not have to be considered for the necessary stable funding.

Also the proposal of the Basel Committee that *Pfandbriefe* with a maturity of more than one year and at least AA rating should be covered by long-term stable funding of 20% is incomprehensible. *Pfandbriefe*, alongside government bonds, are the most reliable of the long-term funding instruments. Even in the acute phase of the financial market crisis, neither the primary nor the secondary Pfandbrief markets were impaired. In accordance with our call in the context of the LCR, that *Pfandbriefe* with at least AA rating should be included in the same way as government bonds without haircut in the liquidity reserve, these securities should in our opinion not have to be covered by long-term stable funding, since they can be sold at any time without loss of value. *Pfandbriefe* with an AA to A rating should be assigned an RSF factor of only 5%.

The corporate bonds referred to in Points 36 and 37, which are to be included with a 40% run-off factor in the LCR, are to be assigned a 50% RSF factor. Here too, the factor is not consistent with the assumed convertibility into cash under the LCR. Accordingly, the securities mentioned should be included at only 40%.

Credit facilities with a residual maturity of less than one year which were extended to non-financial corporate customers are to be assigned a 50% RSF. The extension rate hereby assumed seems to us to be far too high. A lower percentage should be fixed on the basis of empirical investigations.

The same also applies for the assumed extension rate for loans to retail customers with a maturity of less than one year (85%). Here too a lower percentage should be fixed on the basis of empirical investigations.

The proposed full cover of claims on corporates with a residual maturity of over one year with long-term stable funding seems to us not to be materially justifiable. We propose that securities issued by corporates traded on regulated markets and which have not already been allocated an RSF factor of 20% should be

included at only 70%. Loans to corporate customers should be underpinned at only 85% by long-term funding. The lower factors in our view result from considering the portfolio. In the case of long-term loan facilities, there are always redemptions so that for efficient liquidity risk management a certain portion of short-term funding is always necessary.

NSFR adopts an extreme scenario for “other assets and liabilities”. Assets deriving from derivatives are treated as completely illiquid positions (i.e. require 100% stable funding) although there is actually no funding needed. Liabilities deriving from derivatives are treated as short term liquidity run-off (i.e. they do not receive an ASF). Further the described treatment of positive and negative market values arising from derivatives ignores effects of collateral. This approach clearly contradicts the observable market behaviour of these financial instruments. The ability to compare NSFRs between banks depends to a large extent on the applied accounting and netting rules. A coherent approach is essential to ensure comparability and to avoid distortion of competition.

<u>To avoid double counting, the heading “all other assets” should not include assets for which a capital run-off is to be applied (e.g. goodwill).</u>

<u>III. Monitoring tools</u>

<u>Maturity Mismatch</u>

Point 97: We consider the focus on contractual maturities to be unrealistic. In particular, in the retail business, cash investments are often undertaken for an unlimited term. An agreed possibility to give notice is the decisive factor for the possible withdrawal of customer deposits. Nevertheless, observations over decades have shown that only a small proportion of these deposits are withdrawn and a not inconsiderable stock remain in the institution. For this reason, institutions should be able to use their own values as a basis.

In the case of significant changes to the business model, supervisors of the institutions are to call for additional reports showing the effects of the planned measures on the maturity mismatches. In our opinion, such additional requirements on establishing new products would create excessive extra administrative expenditure. It should therefore be abandoned.

<u>Concentration</u>

Point 107: The requirement to assume a funding concentration already from a volume of 1% of the total liabilities seems to us to be excessively conservative from risk points of view; we cannot identify a

concentration risk there. Already the reference to the total liabilities seems difficult to us. In this way for example an institution with a relatively low capital ratio and consequently high liabilities would be less affected by this regulation than an institution with a high capital ratio and few liabilities. In this respect, in our view a ratio should be created on the basis of the total liabilities available for funding.

Point 109: The requirement to assume a funding concentration already from a volume of 1% of the total liabilities seems to us to be in appropriate from the risk points of view. Especially smaller institutions also fund mainly from customer business; funding transactions in the interbank market play a secondary role. In this way, the funding will be divided between a few savings and investment products. However, since the holders of these liabilities-side products are largely heterogeneous, we cannot identify any risk concentration here. A concentration should rather be assumed only from 10%. Such a limit is also to be found in other prudential standards.

Points 111 and 119: In view of the fact that there are about 160 currencies worldwide, but only a few are significant currencies, such as for example the EUR, USD and JPY, the question arises for us of the point of the 1% threshold. We advocate a 10% threshold.

Point 133: We welcome the application of the specifications at group level. This reflects the business economics approach of central liquidity management of many internationally oriented banks. The standards should be applied at the level of subordinated units exclusively if this reflects the orientation of the treasury function appropriately. We consider corresponding waiver regulations to be necessary as a matter of urgency.

Point 134: Experience from the financial market crisis shows that the convertibility of some currencies existed even in acute stress situations. We propose differentiated consideration on the basis of different baskets of currencies.