German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

On the Basel Committee for Banking Supervision's Consultation Paper "Liquidity coverage ratio disclosure standards" (BCBS 259)

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Berlin, 13-10-14

The **German Banking Industry Committee** 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 finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,000 banks.

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Comments "Liquidity coverage ratio disclosure standards"

On 19 July 2013, the Basel Committee for Banking Supervision published its Consultation Paper "Liquidity coverage ratio disclosure standards". We welcome the opportunity to comment on this Consultation Paper.

I. General Comments

After having made major contributions towards the regulation of liquidity risk management of banks under Pillar I and II with its recommendations on the LCR and the "Sound Principles", the Basel Committee currently also plans to cover Pillar III. To this end, the Basel Committee proposes that banks publish their Liquidity Coverage Ratio (LCR) at the same time as their financial statements on or after 1 January 2015. Together with the LCR its material components such as high-quality liquid assets as well as cash outflows and inflows (respectively as weighted and unweighted values) shall be disclosed. Furthermore, the Consultation Paper stipulates that these figures shall be presented as the averages of the daily observations over the previous quarter. These data shall be complemented by further qualitative explanations.

Contrary to the requirements with regard to supervisory reporting, the disclosure obligations are addressed to market participants. This is Pillar III requirement is supposed to enhance market transparency and particularly market discipline.

<u>Procyclical effects of a LCR disclosure during a crisis</u>

On principle, disclosure provides banks with a further incentive for enhancing their risk management. However, a disclosure of the LCR could lead to a situation where the liquidity risks of individual banks might even further compound systemic liquidity risks. If, due to a stressed liquidity situation, another bank's LCR deteriorates, this disclosure would act as a deterrent for other market participants to make liquidity available to this bank; this would result in a downward spiral for said bank's liquidity situation. The same applies to a systemic liquidity crisis. For instance, if external influences lead to the illiquidity of individual formerly highly liquid assets, this would lead to a deterioration in banks' LCR. Again, this is an example where a disclosure would have a further compounding effect upon the crisis due to the fact that there is a risk that banks will make less liquidity available to other banks. The bottom-line is that, in both cases, the disclosure would trigger a self-reinforcing downward spiral. For these reasons, we judge the planned disclosure of the LCR critically. In our view, this risk is not remedied in a sufficient manner by confining the reports to average values.

<u>Disclosure would imply a tightening of supervisory requirements</u>

Under the Basel Committee's proposals, banks are held to report averages of the daily observations over the last quarter. This would mean that all parameter inputs for the report would have to be calculated on a daily basis. As a consequence, the already high amount of resources tied up by the LCR would see another significant inflation. Under the Basel Committee's requirements, the LCR has to be reported on monthly basis. A daily calculation would involve high costs and at least the reconciliation with balance sheet statistics would have to be handled in a pragmatic manner. Furthermore, the data which would

have to be accessed for the purposes of a daily LCR calculation, are not identical with the figures of the financial statement and have not been subjected to an audit process.

In addition to this, in the last bullet of Annex 2 (page 10) the Committee itself acknowledges inconsistencies deriving from different computation methods for the LCRs which have to be reported and disclosed. We share this view. Hence, we strongly object to the methodology suggested in the present Consultation Paper for calculating an average LCR.

By means of the disclosure of an average LCR, the Committee hopes to provide other market participants with a better understanding of banks’ liquidity situation. However, for market participants, the manifest inconsistencies would rather give rise to questions which are not triggered by a bank’s specific situation. Instead, these inconsistencies are but the result of different approaches due to supervisory requirements under national jurisdictions.

We therefore reject the disclosure of the LCR based on averages of daily observations. If the Basel Committee wants to continue with its plans for the disclosure of the average LCR, as an alternative regulatory choice it should at least consider using the average of the last LCR reported to supervisors.

<u>The problem of double calculations would be further compounded</u>

As of 1 January 2014, particularly larger banks will be reporting not only the LCR under the new EU Banking Regulation (CRR) but also, in line with the Basel Committee’s recommendation issued in its January 2013 report, as part of the so-called “Basel III Monitoring”. For banks, this will tie up a considerable amount of additional resources. The mandatory disclosure of the LCR on basis of the Basel requirements would see a further inflation of these costs. In order to avoid double reports, the disclosure of the LCR should be based on the requirements set out by the CRR – as well as the corresponding reporting requirements. What is more, the interpretation of the ratios would be made more difficult by a disclosure under both regulatory frameworks. This cannot possibly be in keeping with the supervisor’s intents and purposes.

<u>Disclosure may give rise to misinterpretation</u>

On principle, there is the risk that the disclosure data will be misread by market participants. Misinterpretations may take place inadvertently, e.g. by analysts, who are not sufficiently familiar with LCR matters. Not every change in individual LCR components may be attributed to a change in the liquidity exposure. In order to avoid misinterpretations, the disclosed ratios would require in-depth comments by banks featuring a corresponding level of detail. Whilst on the one hand, this seems to be in line with the Basel Committee’s motivations, the forthcoming implementation deadlines should take the considerable additional resource requirements into account. Any mandatory disclosure of competition-sensitive data (business strategy) needs to be avoided.

In this context, it is worth noting that particularly the disclosure of un-weighted liquidity inflows and outflows requested by the Basel Committee may lead to misinterpretation. Hence, this proposal is not acceptable.

Disclosure data lacks decision-relevant information

Based on the above, the content of the disclosure set out in the current Consultation Paper constitutes a major cause for concern. Particularly, the broad-based approach which shall be used across all banks alike appears problematic. Due this one-size-fits all approach, banks' idiosyncrasies are not captured in an adequate manner thus potentially leading to a distorted picture of a bank's actual liquidity situation.

Unless the BCBS abandons its current plans for an LCR disclosure altogether, we suggest considering as an alternative regulatory choice that first-time adoption of the disclosure requirements shall only become mandatory after a sufficient trial period in supervisory reporting schemes and possibly corrective action on the part of the supervisor. Furthermore, mandatory first-time disclosure should not collide with the envisaged introduction of supervisory reporting for all banks nor should it collide with the grandfathering period.

II. Specific Comments

Concerning the amendments submitted in the form of the present Consultation Document, we would furthermore like to address the following specific items.

The Basel Committee reiterates that banks may lower their LCR below the threshold of 1 during stress periods (paragraph 6) e.g. by selling liquid assets and using the funds for payments. In our view, the fact that the LCR may under such circumstances fall below the minimum requirement of 100% may be difficult to explain during the disclosure. At this point, the danger of misinterpretations would be particularly grave.

Section 1: Scope of application, implementation date and frequency of reporting (paragraph 10-12)

Paragraph 10: Scope of application

The disclosure requirements set out in the Consultation Paper should be applied to all internationally active banks on a consolidated basis. National supervisors may apply these disclosure requirements to other banks and to any subset of entities of internationally active banks. Although internationally active banks are specified as the target group of the proposed requirements, we would like to point out that, at the European level, the implementation of the Basel III rules in the form of the CRD IV/CRR (the inception of which was equally geared towards internationally active banks) shall essentially also extend to all banks which can be subsumed under the LCR's scope of application. As a result, the latter will have an impact also on smaller banks. We would welcome it if the Basel Committee were to bear this in mind during the ongoing preparation of the forthcoming disclosure regime.

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Hence, the Basel Committee should possibly point out already at this stage that national supervisors may only apply these disclosure requirements in a moderate manner and exclusively after due consideration of the principle of proportionality.

We hold the view that it is appropriate that the disclosure requirements shall apply on a consolidated basis. We doubt the usefulness of extending the LCR's scope of application to the level of subsidiaries. After all, also the disclosure requirements under Basel II (e.g. credit risk) shall only be applied on a consolidated basis.

Paragraph 11 – Implementation date and frequency of reporting

The Basel Committee asks all national supervisors to implement the disclosure requirements no later than 1 January 2015 meaning that banks that are subject to the regulatory scope will have to implement these for the following financial report; in most cases this will translate into an implementation date of 31 March 2015 or 30 June 2015. Given that on a European level the implementation will have to be based on an amendment to the CRR, we hold the view that this timetable would be unrealistic. Our reservations are especially owed to the fact that, at present, this still comes in the form of a Consultation Paper on the level of Basel.

Whilst it appears possible indeed that the European legislator, or, moreover, the supervisor holds a consultation round and publishes respective final rules by this date, the remaining time period would not be sufficient for banks implementation stage. Hence, the present Consultation Paper should already set out a sufficient lead-time for implementation purposes following publication of the national rules.

In our view, the disclosure obligation – if at all – should only take effect once there has been full implementation of the 100% LCR requirement by supervisors. In our view, mandatory disclosure as of 1 January 2015 needlessly reinforces the already existing market pressure for immediate compliance with the LCR of 100%.

Paragraph 12 - Archive

Banks shall create an archive relating to the disclosures. At this juncture, in order to avoid misunderstandings, there should be a clarification that this archive does not require any back re-accounting but that it will begin with the first disclosure report.

Section 2: Disclosure requirements (paragraph 13-16)

Paragraph 14 – Method of calculation (in conjunction with the reporting template and Annex 2)

Parameters must be presented as averages calculated over a period of, typically, 90 days. This is not unproblematic. On the one hand the creation of averages would level out random changes on the disclosure date. On the other hand, averages do not necessarily reflect the bank's current liquidity situation.

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If a bank stays below a LCR of 100 per cent, under the provisions of the CRR this bank should be able to calculate the LCR on a daily basis and to report it to the competent supervisor (Art. 414 clause 2 CRR). Also the current Basel liquidity framework (paragraph 162) requires banks to keep capacities in place allowing them to calculate the LCR on a daily basis. In order to be prepared for various stress scenarios, this basic daily reporting capacity is being implemented within the systems and the respective resources and processes are being put into place.

However, the requirement under paragraph 14 in conjunction with the explanation under Annex 2 (page 9, bullet 5) by far exceeds this requirement which was prepared with a view to stress scenarios /extreme situations. Under the proposals contained in the current Consultation Paper, a daily LCR would have to be calculated for the purpose of disclosing the LCR which will be based on the aggregate values of averages observed during the respective observation period prior to the (interim-)reporting date.

Under the last bullet of Annex 2 (page 10) the Committee itself notes that the heterogeneous method of computation may result in inconsistencies between the items disclosed in the mandatory reporting template and might also result in inconsistencies in the disclosed LCR.

We share this view and thus find the approach for computing a daily average LCR highly objectionable. By disclosing the daily average LCR, the Committee seeks to create a better understanding amongst other market participants for the bank's liquidity situation. Due to the inconsistencies mentioned above and given the potentially major deviations between the daily average LCR and the supervisory (monthly) disclosure LCR, however, market participants will rather begin to ask themselves questions which are not founded in the situation of the bank but which merely result from diverging, mandatory supervisory approaches.

Furthermore, to date the daily calculation of the LCR was only necessary during times of crisis. Under the current proposals, the daily calculation would tie up resources on an ongoing basis involving significant additional costs. This applies – albeit to a lesser extent – also to banks which calculate the figures (for instance for steerage purposes) on a daily basis already today. This is due to the fact that the current calculations are usually not 100% identical with the requested calculations.

We therefore suggest a different approach for the publication of the LCR: Using the LCR already calculated for supervisory purposes, an average LCR will be calculated for the period under observation.

Example: Reporting date 30 June

LCR (Jan, Feb, Mar, Apr, May, Jun) / 6 = ø LCR, disclosure date: financial statement of 30 June. By way of analogy, it is possible to apply a similar approach also to the quarterly disclosure. The daily calculation of all cash flows in the overall portfolio of a bank for the purposes of assessing the liquidity situation is unconstructive and ties up a major amount of resources. A selection of liquidity drivers could be observed on a daily basis – e.g. HQLA, secured lending -, the remainder should be observed on a monthly basis.

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The GBIC would like to reiterate its above caveat that the disclosure may lead to misinterpretations. For instance, the weighted liquid assets could be understood as unrealised losses particularly for Level 2 assets with their higher haircuts.

Paragraph 16 – Additional information

In their disclosure, banks should describe the material drivers of the LCR. Whilst this may indeed be within banks' own vested interests, it will incur major costs especially for smaller banks. For this reason, in view of the principle ofproportionality, a simplified variant should be discussed with the supervisor (whilst not limited to, this should particularly include a waiver from presenting changes during the observation period). At this juncture, we would like to refer to our pointer on paragraph 10 (proportionality).

We have serious reservations over items (c) to (g). The disclosure LCR should allow other market participants a better understanding of a bank's liquidity situation. The disclosures suggested under (c) to (g), however, far exceed this requirement and allow insight into the bank's business strategy.

Page 4 – Disclosure template

At first glance, the presentation of the disclosure template appears plausible. During the European implementation, attention needs to be paid to consistency within the reporting template. It would be helpful to carry out a mapping exercise between the reporting template (ITS) and the LCR disclosure report. This is due do the fact that the latter might be supported automatically by IT centres.

In order to avoid confusion for "naive" readers, line item 19 of the proposed reporting template should be specified in greater detail. The current language might give rise to the impression that cash inflows from non-performing exposures should be listed under this line item.

Notwithstanding the foregoing, the requested information is very detailed and complex. Hence, we would like to point out that the scope of information made available could potentially not be very meaningful and, last but not least, generate additional costs for banks in the absence of any value added which would warrant these costs.

Section 3: Guidance on additional disclosures (paragraph 17-20)

Paragraph 19 lists quantitative criteria which - in the eyes of the Basel Committee – may be used for the purposes of an additional explanation. However, even if paragraph 19 stipulates that "banks may consider" taking into account the following ratios, we are afraid that the list of different possible ratios may induce both auditors and investors alike to treat them as a standard requirement. Banks which lack such an explanatory need, will then still have to supply additional parameters in order to - in the eyes of third parties – create a level playing field between them and other market participants. At this juncture, we therefore propose deleting any ratios or similar lists. Instead, bank should be generally free to make additional disclosures if and when required. At this point, standard requirements applicable to all banks even

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in the absence of any need for additional explanations would result in unnecessary burdens without delivering any apparent additional decision-useful information.

Under paragraph 20, there is a reference to Section 2 (paragraph 16) which sets out that banks are required to provide a qualitative discussion of their disclosed LCR. This is another area where we perceive the danger that the list of various qualitative discussion points will be used as a precedent for a minimum standard. In our view, the disclosure of such operational business transactions provides third parties with an excessively deep insight into a bank's business strategies; hence, at most, it would appear called for only in a genuine stress situation for the bank. What is more, the qualitative points are classical examples to be found under Pillar 2; hence, they are subject thus to the supervisory review process. These matters are also part of the regular dialogue with rating agencies (which, henceforth, shall also comprise the LCR). This means that, even today, these points are not being neglected. Therefore, we hold the view that a mandatory standard disclosure will not be useful.

Along with the qualitative description of the ratio (cf. paragraph 16), banks shall disclose further information on their liquidity risk management. This concerns e.g. the risk tolerance, structure and responsibilities for the liquidity ratio, internal liquidity reporting and communication of the liquidity risk strategy. Here, too, especially with regard to smaller banks it ought to be taken into account that the documentation requirements with regard to Minimum Requirements for Risk Management (MaRisk) are already sufficient. Furthermore, it is doubtful whether disclosure of such information will be necessary for smaller banks (principle of proportionality; cf. comment on paragraph 10).

Yours faithfully,

For the German Banking Industry Committee

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