

Deutsche Börse Group Position Paper on Liquidity Coverage Requirements (LCR) and Leverage Ratio (LR) for the purpose of possible amendments in delegated acts on CRR

## A. Introduction

Deutsche Börse Group (DBG) welcomes the opportunity given in the context of public hearing held by EU Commission on 10 March 2014 to provide our opinion and preferences with regards to the intended delegated acts concerning the leverage ratio based on Article 456 (1) lit. j CRR and with regards to liquidity coverage requirements based on Article 460 (1) CRR.

DBG is operating in the area of financial markets along the complete chain of trading, clearing, settlement and custody for securities, derivatives and other financial instruments and as such mainly active with regulated Financial Market Infrastructure providers.

Among others, Clearstream Banking S.A., Luxembourg (CBL) and Clearstream Banking AG, Frankfurt/Main (CBF), who act as (I)CSD<sup>1</sup> as well as Eurex Clearing AG as the leading European Central Counterparty (CCP), are classified as credit institutions and are therefore within the scope of the European Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR) which transpose i.a. the Basel III rules into European law. Clearstream subgroup is supervised on a consolidated level as a financial holding group.

However, all our group entities in scope of CRD/CRR are offering limited banking activities ancillary to their function as Financial Market Infrastructure (FMI). In order to operate as a FMI and in line with the dedicated regulatory framework (e.g. CPSS-IOSCO principles for financial market infrastructures as of April 2012) as well as generally recognised business practices, the business model of our group entities is risk averse, does not include a trading book / proprietary trading, allows loan business only in connection with clearing, settlement and custody activities for very short durations and in general on a collateralised basis and does not lead to intended financial leverage. Cash received out of the functions of our companies is based on the sole discretion of the clients<sup>2</sup>. It is invested with low credit risk and to a large degree without maturity transformation<sup>3</sup>. Existing maturity transformation (strictly regu-

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<sup>1</sup> (International) Central Securities Depository

<sup>2</sup> Margin/collateral requirements may be fulfilled by either cash or securities to the discretion of the client.

<sup>3</sup> Investments in extremely high and high quality liquid assets in the form of debt securities which are

lated for CCPs) is done based on proper liquidity management principles and not driven by intention to gear net interest income<sup>4</sup>. For the CCP business collateral taken is the consequence of the general political preference for CCP cleared business especially for financial derivatives. In order to secure sufficient liquidity for the CCP function at any time a preference for cash collateral received in comparison to other forms of collateral (e.g. securities) is inherent in the business model. In addition due to highly automated processes operational risk is limited to the extent possible.

With regards to our dedicated business we see the necessity to consider these aspects adequately in the leverage ratio and LCR regime to the extent possible.

The EU Commission is empowered via Article 456 (1) lit. j CRR and Article 460 (1) CRR to amend the leverage ratio and LCR rulings. Further the EU Commission shall submit a report on the impact and effectiveness of the leverage ratio to the European Parliament and Council in accordance with Article 511 CRR. The CRR contains specific mandates for the EBA to develop draft Regulatory or Implementing Technical Standards as well as “Guidelines and Reports related to Liquidity Management and Supervision” in order to enhance regulatory harmonisation in Europe through the single rulebook. In particular:

- Article 509 (3) and (5) CRR tasks the EBA with advising on appropriate uniform definitions of liquid assets for LCR. For this purpose it defines two categories of transferable assets:
  - a. assets of ‘extremely high’ and
  - b. of ‘high’ liquidity and credit quality (HQLA).
- Article 509 (1) CRR in combination with Article 509 (2) CRR also specifically tasks the EBA with advising on the impact of the liquidity coverage requirement on the business and risk profile of institutions established in the Union, on the stability of financial markets, on the economy and on the stability of the supply of bank lending.

EBA has performed the tasks and issued two respective reports (in following “EBA HQLA report” and “EBA LCR Impact report”) which were submitted to EU Commis-

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held without trading intent and the intention to held them until they mature are not considered relevant for maturity transformation in this regard as they can be liquidated via various means immediately.

<sup>4</sup> In general cash collaterals received from clients receive a close to market interest.

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sion. EU Commission is supposed to take views and recommendations expressed therein into account when drafting legally binding delegated acts which must be adopted by 30 June 2014 according to Article 460 (2) CRR.

The document at hand contains a management summary in part B, specific explanatory notes in part C where we share additional thoughts and aspects with EU Commission which should be considered in the upcoming legislative processes and responses to questions in part D.

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## **B. Management Summary**

Per-se we appreciate the mandate of the EU Commission to amend the leverage ratio and LCR framework wherever necessary. In this process we intend to describe our rationales and perspective, especially with regards to our dedicated business model and our prominent role for the functioning of the financial markets. In general we have indeed strong concerns with the current leverage ratio and LCR framework for a variety of reasons, nevertheless at this stage we focus on specific technicalities in both frameworks as EU Commission is entitled for amendments.

We split our comments on leverage ratio and LCR comments:

### **I. Leverage Ratio**

We have generally doubts that the non-risk sensitive leverage ratio with simple calculation basics and unique treatments will add benefits in limiting possible bank failures.

However we strongly support rather simple than complex rules for any kind of regulatory measures as the possibility to fulfil requirements and control the compliance is given to a higher degree of certainty. A flat and unique leverage ratio of e.g. 3% will unintentionally dis-incentivise low risk business and most likely harm risk reducing businesses / activities. We strongly support an approach that is taking into account the specific business model of the institution in scope of the leverage ratio. Otherwise a certain part of institutions are privileged (e.g. investment banks accepting high risk per invested euro) and others discriminated (e.g. low risk business performing high volumes, e.g. institutions financing sovereigns).

Moreover the dedicated role of centrally cleared derivatives as well as CCP business performed by a credit institution needs to be properly reflected.

In addition following topics should be covered in the delegated act:

- We support a flexible approach taking into account specific business models, as well as other specific characteristics;
- The capital base for the leverage ratio should be total regulatory capital and not Tier 1 capital only;
- An equal treatment of derivative positions on Clearing Member (CM) level regardless whether CCP cleared or not is clearly against the general political

will to promote centrally cleared derivatives instead of bilaterally cleared OTC derivatives;

- Derivatives positions cleared with a CCP must be treated appropriately. Cross product netting should be possible for CCP cleared derivatives;
- There exist different CCP concepts which either transfer any transaction on an item by item basis (gross transfer) or on a netted basis (net transfer). Therefore it should be secured that the treatment of CCP positions is done equally regardless of the underlying CCP concept if no economical difference exists;
- The treatment of derivatives positions cleared via a CCP should also be applied for such transactions which are originating from clients and are “passed through” as it is already proposed in the BCBS leverage ratio revised framework BCBS #270 (in the following BCBS #270);
- In order to reflect the role of a CCP being itself in scope of the leverage ratio requirements, CCP positions of that CCP towards its CMs clearly need to be excluded from the exposure measure;
- Furthermore evaluating of derivative exposures via the Mark-to-market method (Article 274 CRR) or the Original Exposure Method (Article 275 CRR) is seen critical as potential future credit exposures are derived by outstanding notionals. While this approach may fit for regular credit institutions it has tremendous implications for central counterparties as outstanding notionals are high and corresponding collaterals are not considered, therefore we support the proposed evaluation of other methods (e.g. the Non Internal Model Method NIMM currently in discussion on the Basel level);
- For derivative transactions of CM on behalf of their clients via a CCP in a segregated model collateral passed through should be ignored for the exposure measure;
- The exchange of variation margins should be considered as p&l balancing and not exchange of collaterals and therefore not be included in the leverage ratio as it is already stated in BCBS #270;
- SFT assets cleared through a qualified CCP should be incentivised;

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- Under-collateralised SFTs should not be discriminated compared to fully un-collateralised loans (the BCBS #270 rulings are therefore explicitly rejected and should not be transmitted into EU law).

## II. LCR

Given the fact that the approach and methodology how high and extremely high liquidity and credit quality of transferable assets should be defined will - in the end - have an impact not only on the liquidity needs for the banking industry as such, but also on the interbank money markets and the overall market liquidity, we see drawbacks of the current high quality asset definition which we address below.

We disagree to tighten the Basel III rules on EU level. In order to keep an international level playing field, the EU should not go beyond Basel III requirements but reflect where appropriate the diversity in the EU banking landscape and adjust the framework where necessary. We support the approach laid down in Article 509 (2) lit. a CRR to consider specific business models of the different financial institutions in the EU . However, we regard the EBA proposal in that context as not sufficient.

- For this purpose we see an essential need for the businesses of CSDs, CCPs and other specific transaction businesses to be properly reflected in the LCR framework (e.g. by extending the 75 % inflow cap derogation/exemption also for above mentioned business models). As such businesses are in principle driven by short term deposits which can be withdrawn at any time, 75% inflow cap would urge them to acquire HQLA most likely with at least mid-term maturities. Beside the impossibility to steer the volatility of the deposits and, therefore, to quantify the need for HQLA ex ante will in any case lead to an unintended maturity mismatch above a reasonable level;
- In addition, (interbank) deposits (and similar funds) posted with specialised transaction banks and FMIs tend to have a certain degree of “residuum”. As such, the outflow rate of 100 % for such funds at the specialised transaction banks and FMIs should be reconsidered;
- Further, the haircuts on HQLA as defined by the BCBS shall be the benchmark also on EU level. In that context we disagree to put Basel haircuts as a minimum which gives the possibility to set even higher haircuts.

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In our view, following aspects of LCR should be reflected in the delegated act:

- Keep level playing field, no tighter rules as defined in Basel III standards should be implemented. This is explicitly true for HQLA (haircuts) and level 2 (maximum) asset levels;
- Follow a diversified approach taking into account specific business models with their specific characteristics. Derogation from 75% inflow cap should be extended to the specific business of FMI and similar transaction (payments) banks;
- Set a reduced run off rate for deposits and similar funds resulting from inter-bank transactional business;
- Adjust the definition of “extremely” HQLA with regards to currency specific rules as it is inconsistent and too narrow;
- Classify covered bonds with excellent rating (ECAI 1) as “extremely” HQLA (Level 1 Assets);
- Consider bonds issued by promotional banks as Level 1 assets, subject to conditions agreed on international level in the Basel III Revised LCR framework. Bonds issued by agencies and guaranteed by regional or local governments should also be classified as Level 1 assets;
- Reflect collateral (pool) solutions which allows collateral substitution appropriately;

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## **C. Specific explanatory notes sections**

### **I. Leverage Ratio**

The G20 decided in their Pittsburgh meeting in 2009 to propagate central clearing and move as many OTC derivatives as possible to CCPs. In order to support this, clear rules to incentive centrally cleared transactions have been initiated, these include:

- Clear regulatory framework for central counterparties including proper supervision;
- Mandatory margining and even more stringent risk (position) management requirements for CCP transactions including default funds and lines of defence;
- Clearing obligations via CCPs for standardized OTC derivatives;
- Reduced capital charge for CCP cleared transactions compared to OTC cleared transactions;
- Additional capital charge (CVA) for non-centrally cleared derivatives;

The current wording in the CRR concerning the calculation of the exposure value for the leverage ratio of derivatives is dis-incentivising CCP compared to OTC cleared business and is therefore not in line with the general political target.

Our topics raised below are reflecting the dedicated business of our group entities and the adequate treatment of CCP business in particular.

#### **1. Definition and minimum requirement:**

So far the CRR did not yet define a certain minimum requirement. On the Basel level it is discussed / proposed to have a 3% minimum requirement, but during a monitoring phase over a full credit cycle until January 2017 institutions' leverage ratio data is analysed to assess whether the proposed design and calibration of the 3% minimum requirement is appropriate. As the Basel rules are supposed to be transferred in European Law we propose to postpone a strict limit on the EU level until the final Basel III rules are settled and react on the Basel framework in a sense that a couple of differentiations are introduced, e.g. appropriate measures for the different types of insti-

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tutions. In the meantime institutions shall report and disclose their leverage ratio without the restriction to meet a certain limit. Further a strict fixation of 3% as a Pillar I limit starting in 2018 might impact various business models to an unintended degree. Per-se a more differentiated approach seems to be sound with less negative implications on the financial system.

Further, institutions with a balance sheet value that experiences high volatilities due to the specific businesses (volatilities must not be a source of additional risk) might suffer from a fix 3% limit. For example the balance sheet volume of our companies is depending on the cash behaviour of our clients which varies sharply within short timeframes depending on their settlement activities or cash collateral supply.

As qualitative criteria to be used to define the different levels of the limit we propose the business model (e.g. investment bank, retail bank, wholesale bank, CCP, CSD, etc.), the size of an institution, etc.

## **2. Capital base**

We are in favour of the usage of total regulatory capital as capital base. From our perspective the coverage of assets is given by any component of the total regulatory capital. Excluding Tier 2 instruments does not seem reasonable. Nevertheless we support the further collection of data for quantitative impact studies to perform further calibration. In case the capital base will be extended and Tier 2 instruments might be included as well, institutions which rely to a large extend or even fully on Common Equity Tier 1 may not be dis-incentivised by increasing the overall limit or not reducing the limit for these institutions.

## **3. Exposure measure**

### **a. On-balance sheet exposures:**

Items which are deducted from Tier 1 capital are also deducted from the on-balance sheet exposure measure. We ask the Commission to exclude items which are deducted from Tier 2 capital from the exposure measure as well as these items are al-

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ready covered by capital and the leverage ratio framework should not contradict the solvency regime.

In addition in case a CCP is in (consolidated) scope of the leverage ratio received cash collateral for initial margins and received contributions to the default fund should be deducted from the total assets as long as they are invested in line with the EMIR rules (for details see section 3.d).

**b. Derivatives:**

The risk and leverage reducing role of a CCP should be taken into account by e.g. cross product netting with a CCP or indirectly via a Clearing Member of a CCP.

It is important to note that there exist various legal means on how CCPs step into a derivative (or other kind of) transaction. There are solutions which transfer (in different legal ways) any transaction on an item by item basis (gross transfer). Other solutions only transfer net positions once a day (net transfer).

As the transfer is the legal basis for accounting, already the starting point for the exposure determination is different. As such, it needs to be secured that the treatment of CCP positions is done equally regardless of the underlying CCP concept if economically no difference exists.

With regards to CCP related client business collateral received from clients and placed with the CCP under a segregated model should not be part of the exposure measure. We therefore ask to include a correction measure to take that collateral independent from the relevant accounting standard and whether cash or non-cash collateral out of the exposure measure. In case our proposal would not be followed, derivatives transactions cleared indirectly with a CCP would receive in our view a double counting unintended (correctly at client level but in addition at clearing member level where it should be corrected).

**c. Securities financing transaction (SFT) exposures**

In line with the revised BCBS #270 framework we support the approach that SFT assets recognised for accounting purposes are replaced by the final contractual (net) exposure if they are cleared through a qualified CCP<sup>5</sup>.

In addition we ask for an explicit treatment of under-collateralised SFTs compared to un-collateralised placements as these un-collateralised placements are taken into account with their on-balance sheet value only while under-collateralised SFTs shall be included in the leverage ratio exposure measure with the notional amount plus an add-on for the under-collateralised part as it is explicitly requested in BCBS #270. While we agree that in line with the concept of the leverage ratio collaterals received are not reducing the exposure value we however strongly disagree to increase the exposure value of SFT transactions by any portion which is not collateralised. This would not only dis-incentivise collateralised SFT transactions especially with regards to cash placements but also economically overstate the risk while in practice the risk is lower. This effect results out of the potential add-on of the value difference of exposure versus collateral, i.e. the exposure value of an SFT may be  $E + (E - C)$  whereas the exposure value of an un-collateralised placement would be  $E$  only ( $E$  shall be the underlying exposure from the SFT and  $C$  shall be the allocated collateral).

**d. Countervalue of received cash collaterals (at CCPs)**

For a CCP being itself in scope of the leverage ratio, received collaterals to cover the CCP risk (initial margin and contributions to the default fund) are the consequence of the general set-up of a CCP<sup>6</sup>. As derivative clearing via a CCP is the political preference and also central clearing for other product types is counterbalancing financial market risk, such collateral should not increase the exposure measure of a CCP. This is in particular true for CCPs being compliant with EMIR, especially with Article 47. For investments in line with Article 47 EMIR intended leverage is more or less precluded as assets must have limited market risk, liquidity risk, etc.

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<sup>5</sup> see footnote 19 in BCBS #270

<sup>6</sup> Usually the collateral received by a CCP is covering the risk positions across products (e.g. derivatives, cash market products, SFTs or commodities).

We therefore propose to deduct the amount of collateral received and shown in the balance sheet from the exposure measure. Furthermore no grossing up should occur in case the collateral received is not shown in the balance sheet which is generally the case when securities or guarantees are given as collateral. As a consequence of the proposed above, equal treatment for CCP collateral of any kind is reached.

## II. LCR

### 1. Keeping level playing field

We see no need to release stricter and/or tighter rules on European level than internationally agreed. This e.g. would be the case for introducing “haircuts” on HQLA in the way it is proposed by EBA. We strongly propose a 1:1 transposition of internationally agreed rules and the set-up of haircuts **exactly** as defined in the revised Basel LCR framework (e.g. 15% for covered, corporate, sovereign and public sector debt securities in Level 2A assets, 25% for RMBS and 50% for equities and corporate bonds rated between A+ and BBB- in Level 2B assets) instead of introducing them as a “lower” boundary as proposed by EBA. This would provide the opportunity to set higher haircuts which, in result, would harm liquidity buffers of EU financial institutions and their international competitiveness in an unduly manner.

### 2. “Deposits and similar funds for transactional purposes”

In order to facilitate payments and financial instruments transactions, sufficient funding at the transaction bank or at a FMI is necessary. While this could be done on a loan basis, this is usually strictly restricted, only allowed for a very short period (to a large extent intraday only) and in most cases costly in case done overnight. Furthermore, such transactions start to occur early in the morning when the respective markets / technical infrastructures open. As such, financial institutions tend to keep funds to some degree overnight at such transaction banks / FMIs. From the perspective of the transaction bank / FMI such deposits tend to be volatile and vary over time. However, beside this volatility there is a substantial portion which is stable and it clearly can be monitored having the characteristics of a “residuum”. Cash collateral placed with transactions banks / FMIs (such as margin collateral at CCPs or cash collateral requested in order to be allowed to participate in the clearing mechanism or to cover

tri-party businesses in the repo or securities lending markets) show an even higher degree of “residuum” also when taking into account that the underlying collateral requirements are varying permanently. In addition the collateral requirements can be met in either cash or securities and an exchange between the kind of collateral is allowed in principal at any time.

Having mentioned the clear “residuum” factor of such funds, they are however not “mandatory” to be held and can be withdrawn or be replaced by other collateral on short notice. As such, they do not qualify for the dedicated treatment of Article 422 (3) CRR.

Taking the similarity of the “operational deposits” and the “deposits and other funds held for transactional purposes” into account, we see the clear need to allow banks / financial institutions being in scope of the LCR and offering transactional services to use a reduced outflow rate for such liabilities from other financial institutions being held for transactional services only (including any cash collateral). Taking the volatility as well as the “residuum” aspects into account, of course the outflow rate need to be substantially higher than that for “operational deposits” as laid down in Article 422 (3) CRR (5% or 25% respectively). We assume an outflow rate of 75% (instead of currently 100%) being an appropriate level and kindly ask the Commission to consider this.

### **3. Definition of extremely HQLA**

In our view, the definition of “extremely” HQLA with regards to currency specific rules is both inconsistent and too narrow. We therefore see the urgent need for amendments. The problem already starts in Article 416 (1) lit. c CRR where there are currency limitations for central and regional governments (i) as well as for central banks and non-central government public sector entities (ii) while this is not the case for the Bank for International Settlements (BIS), the International Monetary Fund (IMF) and multilateral development banks (iii) and the EFSF and the ESM (iv). The rules of Article 416 (1) lit. c CRR show inconsistencies as follows:

1. While non-central government public sector entities are included in (ii), central government public sector entities are not. Those should be set equal to the

- central government and therefore (maybe only for the sake of clarity) be included in caption (i);
2. While for central banks and non-central government public sector entities in (ii) “only” the reference to the domestic currency is made, for central governments and regions with fiscal autonomy the additional requirement of having a liquidity risk in the same country is imposed on top;
  3. While for the items in (i) and (ii) currency restrictions exist, this is not the case for the items in (iii) and (iv);
  4. While regions are only included under the rules in (i), in case they have fiscal autonomy to raise and collect taxes, this is not requested in a similar way for non-central government public sector entities;
  5. While regions and non-central government public sector entities are included ((i) or (ii) respectively), local authorities are not, even if they have fiscal autonomy;
  6. While central governments are referred to explicitly in the context of Member States with an opener to third countries, the reference to Member States for “regions” in (i) is already unclear. As there is no difference between Member States and third countries in (i), this in the end does not matter. Moreover, for central banks and non-central government public sector entities a differentiation for Member States and third countries is left out in (ii) completely. This may be a consequence of an unintended misinterpretation in case the EU intended to have the reference on the “domestic currency” only for third countries.

We clearly see the need not only to remove the inconsistencies but moreover also to widen the scope in that context:

- As we could to some extent understand in general the limitation for captions (i) and (ii) with regards to “domestic currency”, the reference to liquidity risk in a dedicated location does not make sense. Liquidity is managed overall and not with regards to a specific location. Therefore the last half sentence of (i) needs to be removed;
- As there is no differentiation between Member States and third countries (in case our reading of (i) with regards to the reference of “domestic currency”

being valid also for central governments and regions of Member States) in (i) and (ii), the two captions could be merged. In case the dedicated treatment for central governments and regions with fiscal autonomy of Member States is intended to be set regardless of the currency, this should be made clear in the wording;

- There should be no different treatment for central banks and the central government (like for solvency purposes);
- There should be a clear treatment for central government public sector entities. We clearly prefer a unique treatment for all public sector entities;
- Local authorities should be treated like regional authorities and there should be no differentiation between those with and without fiscal autonomy as those without fiscal autonomy rely (ultimately) on the central government and a differential treatment seems not to be justified;
- The ECB should be included under (iv);
- A limitation of multilateral development banks receiving a 0% risk weight for solvency purposes should be considered.

In total, we propose to rephrase Article 416 (1) lit. c CRR like follows:

“(c) transferable assets representing claims on or guaranteed by:

- (i) the central government, a regional or local government, the central bank or a public sector entity of a Member State;
- (ii) the central government, a regional or local government, the central bank or a public sector entity of a third country in its domestic currency;
- (iii) the Bank for International Settlements, the International Monetary Fund, the Commission and multilateral development banks;
- (iv) the European Central Bank, the European Financial Stability Facility and the European Stability Mechanism.

This in our mind would give the right approach. In case a limitation on the “domestic currency” would be introduced also for all or parts of the revised number (i) as proposed above, e.g. sovereign bonds in non EU/EEA currencies issued by central governments of Member States would not fall in scope of the rule. We disagree therefore

also with the EBA recommendation (page 26) in this regards which proposes exactly such a limitation. This would, for example, exclude a German government bond issued in USD from the classification as “extremely” HQLA contrary to a USD bond issued by European Investment Bank (EIB) since there are no restrictions proposed by EBA for Supranational Institutions depending on the currency (i.e. no distinction between EU/EEA and non EU/EEA currencies) in line with the wording of Article 416 (1) lit. c CRR. We overall share the view of EBA not to differentiate between different Member States and therefore to include assets issued or guaranteed by them in a uniform manner.

In addition to that and not covered by the EBA report, we also see room for other assets issued by third country governments to be included in the definition of “extremely” HQLA. The limitation on domestic currency under Article 416 (1) lit. c CRR should not be taken as a final limit as there might be other characteristics which should allow those assets for inclusion. This is e.g. the case for USD denominated bonds e.g. of Canada, Australia, Switzerland or Japan or of EUR denominated bonds of those countries or the USA. These can be covered based on credit quality steps of issuer (country) and instrument under the rules of Article 416 (1) lit. d CRR.

#### **4. Additional outflows**

In our mind the appropriate treatment of collateral is a key to a sufficient liquidity regime as well as for the proper functioning of liquid money markets and therefore this should be reflected appropriately. In this context, Article 423 (5) lit. c CRR (additional outflows) contains a clause, that in such cases where collateral qualified as HQLA was received but could be substituted by collateral which does not qualify as HQLA without the consent of the holder of these collaterals (e.g. in a collateral basket), additional cash outflows must be considered. In our view, this leads to the strange situation that an uncollateralised placement or a placement with collateral not being eligible as HQLA will in principle (depending on counterparty and maturity) count as cash inflow (i.e. qualifies as “liquidity”) whereas a reverse repo with HQLA collateral subject to possible substitution with non-HQLA collateral will count as HQLA (i.e. the collateral will do so) but receive an equal amount as cash outflow without correcting the underlying liquidity again. In total this leads to a reduction of the liquidity position as the funds - i.e. cash - are totally neutralised. Hence, the liquidity for LCR purposes

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is unintendedly lost, while the uncollateralised transaction (and therefore a transaction with lower quality from a liquidity perspective) is still considered as an inflow. Therefore, the current treatment of collaterals with regards to additional outflows for HQLA collateral which might be substituted into non-HQLA is harming the liquidity markets.

We propose to exclude such kind of collaterals from the inclusion into HQLA definition instead of adding an additional outflow and, consequently, keep the underlying cash (subject to fulfilment of CRR conditions) as inflow.

As this represents a change to the CRR as such, we kindly ask the EU Commission to consider that change as a proposal for CRR adjustment.

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#### D. Responses to questions:

##### I. Leverage Ratio:

1. *The criteria for netting of SFT cash receivables and payables with the same counterparty should be?*

Response:

We agree with the criteria set in the BCBS #270:

- (i) Transactions have the same explicit final settlement date;
- (ii) The right to set off the amount owed to the counterparty with the amount owed by the counterparty is legally enforceable both currently in the normal course of business and in the event of: (i) default; (ii) insolvency; and (iii) bankruptcy; and
- (iii) The counterparties intend to settle net, settle simultaneously, or the transactions are subject to a settlement mechanism that results in the functional equivalent of net settlement, that is, the cash flows of the transactions are equivalent, in effect, to a single net amount on the settlement date. To achieve such equivalence, both transactions are settled through the same settlement system and the settlement arrangements are supported by cash and/or intraday credit facilities intended to ensure that settlement of both transactions will occur by the end of the business day and the linkages to collateral flows do not result in the unwinding of net cash settlement.

2. *The criteria for allowing cash variation margins received to be deducted from the derivative exposure value should be?*

Response:

We agree with the criteria set in the BCBS #270 amended parts are in “bold”:

- (i) For trades not cleared through a qualifying central counterparty (QCCP) the cash received by the recipient counterparty is not segregated **from other funds of the receiving party**.

(ii) Variation margin is calculated and exchanged on a daily basis based on mark-to-market valuation of derivatives positions.

(iii) The cash variation margin is received in the same currency as the currency of settlement of the derivative contract.

(iv) Variation margin exchanged is the full amount that would be necessary to fully extinguish the mark-to-market exposure of the derivative subject to the threshold and minimum transfer amounts applicable to the counterparty.

(v) Derivatives transactions and variation margins are covered by a single master netting agreement (MNA) between the legal entities that are the counterparties in the derivatives transaction. The MNA must explicitly stipulate that the counterparties agree to settle net any payment obligations covered by such a netting agreement, taking into account any variation margin received or provided if a credit event occurs involving either counterparty. The MNA must be legally enforceable and effective in all relevant jurisdictions, including in the event of default and bankruptcy or insolvency.

3. *The criteria for allowing the notional amount of written CDS to be reduced with the protection recognition should be?*

No response.

## II. LCR

### **Liquidity Definition of HQLA**

a) *Should the Basel caps at 40%/15% for level 2A/2B HQLA be established?*

Response:

In order to keep a level playing field, we strongly request to have no tighter rules than proposed by the BCBS. However, if need be, some less tight rules or derogations for specific businesses should be considered. We support the view of EBA as reflected in its LCR Impact Report (page 14 and page 44) that the CRR should, in case the caps are introduced, also envisage possibilities to deviate from those caps.

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*b) Should covered bonds be included at level 1 or on an enhanced level 2 basis?*

Response:

As confirmed by EBA in its HQLA report (pages 22 and 26), covered bonds with ECAI 1 and minimum issue size of EUR 500 mn show excellent liquidity. However, we disagree with a qualitative judgement made by EBA which eventually excludes such covered bonds with above mentioned characteristics from the definition as extremely HQLA.

In principle, covered bonds, especially those with ECAI 1 and high issue size, are seen as being of a “high quality” and due to their collateralisation they are usually more liquid in the inter-bank markets than e.g. non-financial corporate bonds or bonds issued by MDBs. As reflected in EBA HQLA Report (page 38) EBA has given them the same liquidity ranking as government bonds and a better ranking than non-financial corporate bonds. In addition, we disagree with EBA’s concerns that covered bonds in times of real estate crisis may not show liquidity features needed to classify them as extremely HQLA. The same is true for government bonds in times of government/sovereign crisis or for bonds in a dedicated currency in times of a crisis in that currency. Any bond can be less liquid in stress times. During recent real estate crisis especially German covered bonds (“Pfandbriefe”) continued to show broad market liquidity.

We also would like to highlight, that our opinion is in line with recital 100 of CRR which explicitly specifies that covered bonds traded on transparent markets with an ongoing turnover would be expected to be considered as assets of extremely high liquidity and credit quality.

*c) Should securitisations other than RMBS included in level 2B HQLA?*

No response.

*d) On what terms should committed liquidity facilities at central banks be accepted?*

No response.

*e) What promotional bank bonds should be eligible as level 1/2 HQLA?*

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Response:

We disagree to the EBA Recommendation made in HQLA Report (pages 24 and 27) that in general declines bonds issued by promotional banks as HQLA. This is conflicting with the rules as set up in Article 416 CRR.

We are in favour of the Basel approach which allows considering bonds issued by promotional banks (if all conditions defined in paragraph 50 lit c. Basel III Revised LCR framework BCBS #238 such as 0% risk-weight assigned to the bonds under the Basel Standardised Approach for credit risk, market tradability etc. are satisfied) as level 1 assets. In Germany, the quality of assets of promotional banks is similar to the government bonds of Federal Republic of Germany. We see no reason to exclude all bonds regardless of issuer quality or credit assessment of guarantor of total stock of HQLA. We also suggest adding promotional bank and agency bonds guaranteed by regional or local governments as level 1 assets.

*f) What rules should apply to deposits in a cooperative network (Basel/CRR)?*

No response.

*g) What should be the operational requirements for liquid assets (Article 417 CRR)?*

Response:

We are aware that currency management is an essential part of liquidity management. However, the denomination of assets should reflect in an appropriate manner the distribution of currency of liquidity outflows after the deduction of uncapped inflows at least for major outflow currencies. Nevertheless, this should not lead to a requirement to have them covered “consistent” as laid down in Article 417 lit. f CRR as we see this is being too restricted in a sense of being covered at least to 100%. If the overall ratio is kept, fluctuations in in- and outflows per currency will always lead to coverage ratios being above but also below the full coverage and as long as proper possibilities to exchange liquidity cross currency without material cost and delays exist, it cannot be mandatory to keep the ratio per currency as a consequence of “only” operational requirements. Furthermore, in small currency markets it might be necessary already in the course of large exposure limits to swap out currency positions

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overnight in order to place the funds with different counterparties and / or in different currencies with sufficient liquid (collateralised) money markets.

### **Liquidity – Outflows and Inflows**

*a) What criteria should be applied to qualify as an established operational relationship for lower deposit outflows (Article 422 (3) lit. c CRR)?*

Response:

We have no specific comments to operational relationships. However we refer to our comments made on deposits and similar funds for transactional purposes in part C of the document at hand.

*b) Should there be a natural person deposit threshold (Art. 411(2) CRR) and on what basis should possible higher outflow rate for retail deposits (Art. 421 (3) CRR) be included having regard to the three higher risk buckets/ risk methodology set out in the EBA guidelines? In addition should the LCR specify the outflow rates for higher risk deposits?*

No response.

*c) In the light of the political agreement on the DGS, should and if so when, a lower 3% retail deposit outflow rate be envisaged?*

No response.

*d) What additional objective criteria for cross-border intragroup flows (Article 422 (9) and 425 (5) CRR) should be applied? Should inflows/outflows be symmetrical / asymmetrical?*

Response:

We are in favour of asymmetrical approach: no dedicated treatment for inflows but reduced outflow rates for intragroup outflows. In intercompany relations commonly the possibility to influence the withdrawals to some extent can be assumed. As such, beside contractual obligations the repayment of liabilities has higher likelihood of a

possible delay being accepted, compared to delays related to third party liabilities. Contrary, cash inflows in that context may be even shifted forward and, therefore, in any case can be regarded being at least of the same liquidity than those of third party.

We consider setting the outflow rates to 50% of the respective standard rate as appropriate for this purpose. In case of specific circumstances, CRR allows competent authorities to increase the outflow rates at any time needed, so that our suggestion is appropriate also from prudential perspective. In case the circumstances would not be appropriately reflected with the reduced intercompany outflow rates, the competent authorities would have therefore the possibility to increase them anyway.

*e) Should a distinction be made between credit and liquidity facilities in outflow rates (Art. 424 CRR) and according to counterparty?*

Response:

We share the view of the EBA and do not see any need to amend currently valid outflow rates as defined in article 424 CRR. A draw-down rate of 100% tested by EBA and described in LCR Impact report would in our view seriously overestimate the drawing of committed lines to non-financials so that the costs outweigh the benefits of the increase. In addition, such a substantial divergence from the Basel rules text would create an unlevel playing field in the competition for non-financial corporate customers, strongly penalising EU banks.

*f) Should there be an inflow cap equal to 75% of outflows (Art. 425 CRR) and what exemptions should be granted? (pass-through financing, promotional loans, auto and consumer loans, leasing and factoring)*

Response:

EBA suggested in its LCR Impact report (page 11) to allow some business models like auto or consumer credit banks to apply higher than 75% inflow cap as defined in Article 425 CRR. Contrary to the EBA's finding related to high LCR ratios of CCPs, (page 10 of LCR Impact report), CCPs, at least those which are significant in size, will by their business model almost always have a LCR close to 100%. This is due to the fact that CCPs (being itself in scope of the CRR), have in principle only short term

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deposits (collaterals) to be drawn/replaced (sufficient remain call assumed) being placed highly liquid or held of banks at sight. Due to volatility of deposits while nevertheless showing a certain degree of “residuum” which can not be predicted, the inflow cap is an unduly threat. As both sides of balance sheet are to a large degree short term or consist of liquid assets, no inflow cap or at least a higher inflow cap should be applied. Similar arguments are valid for CSDs.

As CCPs, CSDs or similar transaction banks being in scope of CRR and, subsequently, LCR rules, may also perform other businesses, we however do not propose to exclude such institutions as a whole. We rather recommend removing the inflow cap based on the characteristics of the liabilities. This could be done e.g like follows (by suggesting an amendment of Article 425 CRR):

*“Institutions shall report their liquidity inflows. Capped liquidity inflows shall be the liquidity inflows limited to 75% of liquidity outflows. However, such a cap should not be applied related to outflows in the form of cash collateral for transactions in financial instruments such as margin collateral at CCPs or held for the purpose of transactions in financial instruments...”*

The inflow cap for such funds is implicitly set to 100%.

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We hope that our comments given are useful in the further process and are taken up going forward. We are happy to discuss any question related to the comments made.

Eschborn

31 March 2014

Jürgen Hillen

Matthias Oßmann