

I. Key Messages

A- General comments

The French Banking federation welcomes the opportunity to comment on the EBA consultation paper related to the draft regulatory technical standards on additional liquidity outflows corresponding to collateral needs resulting from the impact of an adverse market scenario under Article 411(3) of the draft Capital Requirements Regulation (CRR).

We do, however, have some concerns related to the proposed methods, which are described in detail in the following pages.

❖ Consistency with the LCR framework

Our key concern is the inconsistency of the current proposal with the LCR framework. **It is not acceptable that additional liquidity outflows are based on a scenario where value of securities appreciates while a liquidity risk is based on the opposite scenario! As an example**, financial equities which are deemed to be illiquid for LCR can't be assumed to appreciate by 20, 40 or 60% (in the Standard Method)!

As a consequence, the suggested methodologies (Simplified, Standard and Internal) should be adjusted to be LCR-scenario-consistent.

In the simplified and standard methods the market scenario should assume a unique downward scenario for securities consistent with the LCR framework, i.e. with article 423-1; no change in values of Extremely High Credit and Liquid Quality and 20% decrease in values for the other assets.

Since article 423-1 does not take into account repos; these operations shall be included into the perimeter of the current RTS in case they are under margining set. The inclusion of derivatives and repos that mature during the 30 days horizon shall be evaluated by EBA:

- An additional market risk shall not hit repos that are hit by the partial roll-over depending of the stressed value of the collateral ;
- **Derivatives that close out during the 30 days shall be taken into account with the close out of their hedge according to article 418(1) (if an equity decrease, a positive margin flow will come out in? the future).**

In terms of final calibration of the method and of its parameters, we urge EBA to use the LCR observation period to conduct Quantitative Impact Studies on the proposed methodology. Without those QIS's, EBA could not estimate the cost/benefit analysis.

❖ **Need for a specific consolidated treatment**

The methods proposed by the EBA allow obtaining an assessment of the additional collateral outflows that makes sense economically at a solo entity level. However, there is no specific consolidated treatment considered by the EBA at this stage. It is proposed that institutions estimate the additional collateral outflows at a group level by aggregating the outflows calculated in the solo entities. FBF is not in favour of this approach.

Indeed, the proposed methods may lead to an estimation that two solo entities would both experience outflows on the same intra-group transactions. On the solo entities level, this makes sense, but on the consolidated level, the aggregation does not reflect the actual liquidity risk experienced by the Group.

In addition, the approach proposed by the EBA will penalise the banking groups having a centralised management of their collateral even though this organisational model generally tends to reduce the operational risk within the group.

For these reasons, we strongly support a specific consolidated calculation excluding intra-group transactions that would make sense economically and then strengthen the liquidity risk management.

❖ **Need for more flexibility in the choice of the methods**

The draft RTS does not allow institutions to combine methods for calculating their additional outflows and to revert from the use of a method to the use of less sophisticated one which seems very restrictive. FBF calls for more flexibility on this matter.

Indeed, the methods proposed by the EBA are based on the underlying principle that the less complex are the methods, the more conservative estimates of additional outflows they produce. Consequently, it does not seem necessary to add more restrictions.

The approach based on the historical data described by the Basel Committee in January 2013 should be considered as a method of calculation of its own.

Generally institutions are always willing to improve their models of liquidity risk management, but they will need time to implement the most sophisticated methods.

❖ **Need for a better harmonization of the outflow factors**

We think there are some inconsistencies between the outflows factors defined in this RTS and the hypotheses underlying to the LCR scenario in the CRR. These inconsistencies are particularly prominent regarding the shocks applied to securities (debt and capital instruments, including non-liquid assets).

Indeed, in the LCR framework, different hypotheses are used to:

- value the liquid assets;
- determine the outflows on collateral already posted;
- operate the stress to be applied.

For instance, considering a derivative collateralized by an equity, as per the article 423 (1) the outflow factor to apply to the posted collateral will be fixed **downwards** shock of

20%; while an option on the same equity will be submitted under the standard method to an **upwards** shock of 20%, 40% or even 60%.

We think that a harmonization of the hypotheses to be applied to the liquid assets, collateral other than liquid assets already posted and collateralized derivatives, is necessary in order to capture all the collateral outflows in a consistent manner.

❖ **Attention should be paid to the reduction in European's banks financing capacity**

As each European bank will be subject to LCR, including an additional liquidity outflow for collateralized transactions, each of which will be based on a bank-specific adverse scenario, the additional outflows will decrease the funding capacity of European banks as a whole.

To illustrate, let's consider that European banks were dealing only with other European banks. Then, at global European banking level, there should be no need for a buffer and no need to allocate a portion of their available funding to this buffer. However, as each European bank will have to build up a portion of its liquidity buffer and dedicate a portion of its available funding to additional liquidity outflows for collateralized transactions, it will decrease the amount of financing capacity of each European bank to the detriment of other assets to be funded (notably loans). This effect will be all the more important as the individual level adverse market scenario are different between different banks.

What is true at European level as a whole applies at each group level: there will be a loss of financing capacity.

B- Specific remarks on the different methods mentioned by the EBA

Simplified method

French banks plead for not restricting the use of this method only to the entities for which the calculated additional outflows do not exceed 5% of the liquid assets reported by the entity.

Indeed, among the 3 approaches presented in the CP, this simplified method will be, by far, the easiest one to implement.

And considering the costs and the time necessary for the implementation of the 2 other methods, most of the banks will not be ready on time to calculate their additional collateral outflows if they are not authorized to use the simplified method.

Moreover, once again, the conservative calibration of the shocks in the simplified method should be sufficient to give a strong incentive to institutions to move, as soon as they can, to a more sophisticated approach.

Furthermore, there is an important methodological concern with the simplified method due to the fact that it does not take into account any netting effect. By selecting only the larger of the notionals, the effects of netting between two positions having opposite sensitivities to the same risk factor are not taken into account.

In the case of an entity which is in perfect back-to-back, this will lead to the calculation of additional collateral outflows making no sense economically. This concern could be

addressed by applying the shocks defined for the simplified method to the net amount of the exposures sensitive to opposite movement for a same risk factor.

Standard method

There are two main methodological concerns regarding the standard method. Those are related to the scenarios defined for the FX and credit risk factor.

Regarding the FX risk factor, the scenario requires some clarifications on the way it should apply. For the credit risk factor, we don't favour shocks based on hypothesis of downgrade of the reference entities, to apply to the single name and basket transactions, because it is difficult to predict the impact of a downgrade on the credit spread and hence on the valuation of credit derivatives. A direct shock on the credit spreads, the same way it is expected when the underlying is an index, would be much simpler and straightforward.

Moreover, a three notches downgrade of all the counterparties is a very severe scenario and it does not seem to us, consistent with the hypotheses underlying to the LCR scenario. Indeed, the LCR scenario is mainly idiosyncratic and if a three notches downgrade hypothesis makes sense when it applies to the rating of the considered institution, we do not think it is consistent with the LCR scenario when it is generalized to all the counterparties. If this scenario is retained, then the contractual inflows from any downgrade trigger on counterpartys' ratings should be recognized.

In the simplified and standard methods the market scenario should assume a unique downward scenario for securities consistent with the LCR framework, i.e. with article 423-1: no change in values for Extremely High Credit and Liquid Quality and 20% decrease in values for the other assets.

Since article 423-1 does not take into account repos, these operations shall be included into the perimeter of the current RTS in case they are under margining set. The inclusion of derivatives and repos that mature during the 30 days horizon shall be evaluated by EBA:

- An additional market risk shall not hit repos that hit by the partial roll-over depending of the stressed value of the collateral ;
- **Derivatives that close out during the 30 days shall be taken into account with the close out of their hedge according to article 418(1) (if an equity decrease, a positive margin flows will come out of the future).**

Internal model method

We think the internal model-based method, because of the precision of the estimates it gives, is virtuous and will tend to incite institutions to reduce their sensitivity to market risk factors on collateralized derivatives.

As for the standard method, the use of the internal model approach to calculate the additional collateral outflows may lead to consider inconsistent scenarios with the LCR framework (equities going up, etc.). To address this issue, we urge EBA to use the LCR observation period to conduct Quantitative Impact Studies on the proposed methodology. If EBA still wants to put it in place, French banks consider too conservative the scenario that corresponds to the 99% confidence and favours the percentile 80% **intermediary between the 65% (expectation over adverse market scenario, as is applicable to EPE) and 99% (extremely adverse scenario)**. This reduced level allows taking into account the lower correlation existing between the movements of the market risk factors (except for the credit derivatives) and the liquidity crisis, than the one existing between the liquidity crisis and the actors' behaviours having an impact on the funding instruments (deposits run-off, drawdown on credit and liquidity facilities etc.). And operations that close out during the 30 days horizon shall be excluded.

II. Answer to specific questions

Q1: Is there any specific category of contracts subject to this Regulation that could only lead to immaterial additional outflows? If so, could you explain why and clearly specify the type of contract?

The term 'immaterial' is not defined. We suggest it is defined as 'less than 5% of the LCR Buffer of the reporting institution. Once the threshold for materiality is defined, there is no need to exclude or include a priori specific types of contracts: they will be included or excluded by application of the threshold.

Q2. Does the specification in paragraph 2 give sufficient clarity on which flows are included and excluded for the purposes of this RTS? If not, please provide us with an alternative specification.

The specification in paragraph 2 calls for clarifications regarding b). Indeed, the wording of 2b) seems to us subject to interpretations.

We understand this RTS aims at defining the methodologies to assess the additional outflows corresponding to collateral needs resulting from the impact of an adverse market scenario that institutions should add for all transactions and contracts that are not already covered by the CRR.

Reading 2b), we understand that all the additional collateral outflows resulting from the value changes of the collateral posted are excluded from the scope of this RTS.

Excluding the SFT which underlying is a liquid asset as per article 416 is relevant, since the article 418 (1) already gives the haircuts to consider. It seems also relevant to exclude from the scope of this RTS the collateral posted as defined by the article 423 (1).

However, French banks strongly favour a consistent treatment and a harmonization of the outflow factors to apply to the collateral posted and the collateral outflows resulting from the impact of a market stress. For instance, regarding a derivative collateralized by an equity underlying, the outflow factor to be applied according 423 (1) of CRR would be 20% while an option on the same equity would be submitted to a stress of 20%, 40% or even 60% in the standard approach.

We take an economical approach:

- **This RTS should include all operations that are under margining requirements ;**
- **The assumptions related to securities shall be consistent with article 418-1 ;**
- **Operations that close out during 30 days shall be considered with their hedge and shall be excluded from the scope of this RTS.**

For sake of clarity, it would be helpful that the RTS specifies that it covers only the transactions that could lead to cash in-/out-flows in the next 30 days.

Q3. Would your institution face additional collateral outflows from securities financing transactions for other reason than a decline in value of the collateral? If yes please provide us with a detailed description on the type of contract, the reason for the outflow and the approximate volume.

The collateral outflows that we face from securities financing transactions understood as repos/reverse repos, securities borrowing/lending and collateral swaps are always related to a decline in value of the collateral posted.

Q4. Are paragraphs 2c and 2d sufficient for reducing incentives for cherry picking behavior? Are there other specifications that could help this purpose?

Paragraphs 2c and 2d are too restrictive and prevent the institutions from benefiting from a pragmatic assessment of additional collateral at a reasonable cost, in a reasonable period of time and depending on the systems and tools already available.

As the LCR applies to the institution level, consolidated level and sub-consolidated level (liquidity sub-groups), it should be clarified that paragraph 2c applies at institution level. The fact that institutions shall not combine methods will lead for an institution in some cases, to a less accurate assessment of additional collateral and to increase the implementation cost of this regulation. This is the case for instance when an entity A trades some of its derivatives with another intra-group entity B, having implemented the internal model method. Indeed, the entity B could provide to the entity A the valuation through the advanced approach of the transactions traded between them. For the remaining stock, the entity A could use the simplified approach.

It could be a difficulty for entities that have validated EPE for capital market operations but where EPE does not necessarily cover all derivative activities. Those entities should be able to take EPE even if a small portion of operations would not be picked up. For this kind of entities, it should be accepted to switch to EPE when validated by national supervisor.

The combination of the 2 methods would give a very good assessment of the collateral needs resulting from the impact of an adverse market stress scenario without significant increase of implementation costs neither for entity A or B. However with the paragraph 2c, this approach is not possible and the entities will have to develop with substantial costs the standard method which is less sophisticated.

Moreover, we understand that the less sophisticated the method is, the more it costs in terms of additional outflows; consequently there is no need to add restrictions of this type. Generally institutions are always willing to improve their models of liquidity risk management, but they will need time to implement the most sophisticated methods.

Basically, paragraph 2d requires that there is no way back from a more 'sophisticated' method to a less 'sophisticated' method with order by 'sophistication': Simplified Method < Standard Method < Internal Method.

In theory this would be the logical progress in order to have more precise calculation. But the current simulations show that Unexpected Negative Exposures (UNE) gives a much higher outflow than the standard model because the underlying scenario is even more inconsistent with the LCR scenario than the standard model.

We urge EBA to make a monitoring during observation period before deciding on a set of methodologies.

As there may be circumstances that would justify such changes from an institution, notably when its collateralized transactions decrease in importance (materiality), we suggest that paragraph 2d is reworded in: '*institution shall not revert from...*' to '*institutions shall not revert, without approval by their supervisor, from...*'

Note that the combination of paragraphs 2c and 2d may be interpreted at group (or sub group) level as a 'tainting rule' that requires the whole group (or sub group) to apply the most sophisticated method applied in the group. Our understanding is that it is not the intent of the RTS. Once having clarified paragraph 2c as suggested above, this combined interpretation risk will no longer exist.

Q5. Are there any aspects of the standard method that you would describe differently? If so, how would you describe these? Are there methodological concerns? If so, what are these and how should they be addressed? Are the scenarios described in annex I appropriately calibrated? If not, how would you suggest improving calibration?

1. General Comments:

Retained Adverse Market Scenario could be inconsistent with LCR underlying systemic crisis scenario:

We think there are some inconsistencies between the outflows factors defined in this RTS and the hypotheses underlying to the LCR scenario in the CRR. These inconsistencies are particularly prominent regarding the shocks to apply to the securities (debt and capital instruments, including non-liquid assets).

Indeed, in the LCR framework, different hypotheses are used to:

- value the liquid assets;
- determine the outflows on collateral already posted;
- operate the stress to be applied.

For instance, considering a derivative collateralized by an equity, as per the article 423 (1) the outflow factor to apply to the posted collateral will be a downwards shock of 20%; while an option on the same equity will be submitted under the standard method to an upwards shock of 20%, 40% or even 60%.

This does not seem consistent to us and we would recommend a harmonization of these hypotheses.

The suggested Standard Method assumes that each individual risk factor could change in isolation of the other risk factors, without considering whether the retained most adverse market scenario is consistent with the LCR scenario (systemic crisis), the other LCR assumptions or economic sense.

As an illustration, the retained adverse market scenario may correspond to an increase value for equities, a decrease value in credit spreads, and increase in rates: those assumptions are not only internally inconsistent, but they are inconsistent with the LCR.

Introduce a weighting process to ensure economic sense:

To mitigate that inconsistency, it would make more sense that:

- some combinations of changes in risk factors are excluded:
 - Equities could not go up
 - Credit spreads could not go up

The Standardized Shock can lead to internal inconsistencies or double counting:

All the valuation process is done within the 'arbitrage free'- framework. This means that, once a risk factor is modified, it may have consequences on the future values of other risk factors.

As illustrations

- If different shocks are applied to different interest rate curves of different currencies, the 'arbitrage free' valuation framework will lead to changes in future values of foreign exchange between those currencies. Hence, interest rate shocks have ramifications on foreign exchange risk factor.
- If equities are assumed to decrease in values (resp. increase) 'arbitrage free' valuation framework will lead to increase (resp. decrease) in credit spread values .

Hence, the 'arbitrage free' valuation framework can lead to possible double counting the effect of some risk factors (foreign exchange risk and credit spread risk in the above described examples).

Shocks to apply to the credit risk exposures:

There is also a concern regarding the shocks to apply to the credit risk exposures, based on the downgrading of the reference entities for single name and basket contracts.

Firstly, a three notches downgrade of all the counterparties does not seem consistent with the hypotheses underlying to the LCR scenario. Indeed, the LCR scenario is mainly idiosyncratic and if a three notches downgrade hypothesis makes sense when it applies to the rating of the considered institution, we do not think it is consistent with the LCR scenario when it is generalized to all the counterparties.

Moreover, the assessment of the impact on the contract value resulting from two or three notches downgrade of the reference entities is not straightforward and will require new stress models to be implemented (in order to define for instance what shock should be applied when a reference entity has never been downgraded?).

This is time-consuming and expensive.

Consequently, it would be much simpler and straightforward to have pre-determined standard shocks to apply directly to the credit spreads of the reference entities, the same way it is envisaged when the underlying is an index.

Standardized shocks on foreign exchange are unclear:

The scenario related to the foreign exchange rate risk factor would require some clarifications. This could lead to cumulative shocks to some foreign exchanges. Moreover it represents a very severe 30-day period stress.

We do not understand how it should apply to the FX positions. Is it sequentially or should the moves on the FX rates of the reporting currency, most, second most and third most

important currency occur simultaneously? In both cases, a numerical example would be highly appreciated.

Low rate environment:

In the current low rate environment, it should be made clear how to deal with applying downward scenario on interest rates that could lead to negative values.

A possible answer would be to clarify that nominal interest rates should be floored to 0%. However, as interest rate shocks are not similar for short term and long term rates, as well as the initial values, the flooring process could lead to applying a lower shock to short term rates (as the floor may kick in) and the full shock to long term rates (if the floor does not kick in for long term rates).

Possible alternative to the prescriptive Standardized Scenarios: stressed market risk scenario:

As an alternative, banks might be allowed to use their market risk scenarios which are already well established, subject to supervisory oversight and adjust dynamically in order to take into account the evolution of derivative exposures.

As suggested above, the market risk scenarios should be weighted so that the scenarios that are less consistent with the LCR underlying systemic crisis scenario should be allocated a lower than 100% weight.

Final calibration of the shocks and methodology:

In terms of final calibration of the method and of its parameters, we urge EBA to use the LCR observation period to conduct Quantitative Impact Studies on the proposed methodology. Without those QIS's, EBA could not estimate the cost/benefit analysis (please refer to our response to Question 24).

How should Initial Margin be covered by this requirement?

It is not clear whether *Initial Margins* are covered by this RTS that seems to focus on changes in *Variation Margins*.

In our opinion, as *Initial Margins* cover the very same risk with a mitigating multiplying factor relating to the default probability, the additional outflows for collateralized transactions should be netted out of posted *Initial Margins*.

Q6. What instruments transactions and contracts are you aware of that are sensitive to changes in multiple risk factors? How material are they to your institutions stock of assets of extremely high and high liquidity and credit quality as calculated in accordance with Part Six of CRR? Does the standard method capture these adequately? If not, what alternatives would you consider necessary to ensure they are appropriately incorporated?

FX forward transactions or multi-underlying exotic options are products sensitive to changes in multi-risk factors for instance.

As long as the multi-risk factors are identified, we do not see any concern with the standard method to capture these.

Q7. How do you view the restriction in paragraph 2, point h(ii) that only additional inflows of extremely high liquidity can be recognised outside of margining sets? To what extent do assets of typically lesser liquidity constitute part of collateral flows for your institution? What assets are they? Do these assets typically comprise outflows, inflows or both? How material is it for the LCR of your institution?

Such a restriction will significantly increase the demand for collateral of high liquidity and credit quality and then contribute to phenomenon of top-collateral crunch.

The avalanche of regulations that require collateral creates a 'collateral famine' creating a huge demand for collateral that may exceed the available collateral. That is the reason why it is important that eligible collateral is not overly restricted, directly or indirectly by this type of over-penalizing treatment.

As the avalanche of regulations is happening, collateral management is changing or is expected to change to accommodate for all the regulatory-driven changes. The effect of the restriction on current collateral management practice is irrelevant for a regulation that will apply for the foreseeable future.

For this reason, we think that the condition ii) of the paragraph 3 should be less restrictive and allow the inclusion of collateral of lesser quality as per the article 416(assets that are Level 2 in the Basel III framework should be counted as inflows, be it with a haircut), as long as this collateral is unilaterally and immediately available to cover outflows to any other counterparty.

We urge EBA to delete this restriction as described below:

- Art. 2(3)(ii): (ii) the inflow of collateral is a cash inflow or a liquid asset as reported in accordance with Article 404 416(1)(a) to (e) (f) of Regulation xx/xxx [CRR, unless excluded according to Article 404 416 (2) or Article 404 416 (3) of Regulation xx/xxx [CRR].

Q8. What are the expected implementation costs of the standard method and what is the time you would need for implementation? If possible, please compare it to the implementation costs of the other methods.

The expected costs as well as the time needed for the implementation of the standard method will be generally medium to high for the entities that are not sophisticated. Indeed, it will require for them to the capacity to calculate NPV sensitivities, which is never straight-forward even for experts.

Q9. What impact in terms of liquidity coverage requirements do you foresee of the application of the standard method on your institution?

Considering the complexity related to the implementation of the standard method, we are not able to provide an accurate assessment of the impact in terms of liquidity requirements. However, the first figures that we get, show a material impact. In terms of final calibration of the method and of its parameters, we urge EBA to use the LCR observation period to conduct Quantitative Impact Studies on the proposed methodology. Without those QIS's, EBA could not estimate the cost/benefit analysis.

Q10. How would you view an insertion of a special foreign exchange rate shock for currency pairs between the Euro and a currency participating in the ERM II? If positively, what shock factor would be appropriate, taking into account compulsory intervention rates?

The participants States to ERMII concerned by the insertion of a special foreign exchange rate shock would be:

- Denmark
- Lithuania
- Latvia (which will enter the euro zone next year)

For Lithuania and Latvia, the fluctuation band of $\pm 15\%$ in ERM II for the currency pairs EUR/LTL and EUR/LVL is in line with the foreign exchange rate shock specified in the standard method. So we do not view any special foreign exchange rate shocks to be defined for these currencies.

On the other hand, regarding the Denmark, the EUR/DKK peg in ERM II is much more narrow ($\pm 2.25\%$), and may justify the insertion of a foreign exchange rate shock lower than the 15% shock specified in the standard method.

Q11. Are there any aspects of the simplified method that you would describe differently? If so, what are these and how would you describe them? Are there methodological concerns? If so, please provide details of these concerns and how in your view they could be addressed? Are the outflows factors described in annex II appropriately calibrated? If not, please describe how they should be calibrated, justifying your proposal?

Complete the specifications of the simplified method

Specifications of the simplified method give sufficient clarity on what it is expected.

However, they could be completed by some practical examples allowing to precise the expected reporting for vanilla rate derivatives such as basis swaps (exchange of two floating rates in the same currency), cross currency swaps for instance.

Moreover, there is an important methodological concern with this methodology since by selecting only the larger of the notional exposures per risk factor, it does not take into account any netting effect.

For instance, an entity in back-to-back which has only two interest rate swaps with opposite interest rate sensitivities will have to consider an additional outflow even though economically it does not make sense since the entity is perfectly hedged.

This concern should be addressed by applying the shocks defined for the simplified method to the net amount of the exposures sensitive to opposite movement for a same risk factor.

Threshold should be based on the whole LCR-Liquidity Buffer and not a portion of it:

The materiality threshold for the Simplified Method should consider the whole liquidity buffer and not a portion of it:

- *Art.3 '1. As an alternative to the standard method, institutions may use the simplified method where their overall additional outflow according to the simplified*

method does not exceed 5 % of liquid assets reported in accordance Article 404 416(1)(a) to (e) (f) of Regulation xx/xxx [CRR, unless excluded according to Article 404 416 (2) or Article 404 416 (3) of Regulation xx/xxx [CRR].and only if the conditions of paragraph 3 of that article are met on any day. '.

How should Initial Margin be covered by this requirement?

It is not clear whether *Initial Margins* are covered by this RTS that seems to focus on changes in *Variation Margins*. In our opinion, as *Initial Margins* cover the very same risk with a mitigating multiplying factor relating to the default probability, the additional outflows for collateralized transactions should be netted out of posted *Initial Margins*.

Final calibration of the shocks and methodology:

In terms of final calibration of the method and of its parameters, we urge EBA to use the LCR observation period to conduct Quantitative Impact Studies on the proposed methodology. Without those QIS's, EBA could not estimate the cost/benefit analysis.

Q12. What are the expected implementation costs of the simplified method and what is the time you would need for implementation? If possible, please compare it to the implementation costs of the other methods.

Among the 3 approaches proposed by the EBA, the simplified method seems to be the cheapest (in term of implementation costs) and the fastest one to implement.

The costs as well as the time needed for the implementation of this method are not expected to be high.

Q13. What impact in terms of your institutions liquidity coverage requirement do you foresee for the application of the simplified method? How would this compare to the 5% threshold that is specified in paragraph 1 article 3?

Considering the first estimates that we get by using the simplified method, this approach is too penalizing and it does not seem conceivable to use it.

In terms of final calibration of the method and of its parameters, we urge EBA to use the LCR observation period to conduct Quantitative Impact Studies on the proposed methodology.

Q14. Would a special treatment of the narrowest of the currency pegs of the ERM II be appropriate? If so, what shock factor would be appropriate?

Please refer to the answer of the question 10.

Q15. Are there any aspects of the advanced method based on EPE that you would describe differently? If, so please provide details? Are there methodological concerns? If so, please provide details of these concerns and how in your view they could be addressed? Are there any additional adjustments or conditions that you see as appropriate especially in view of an absence of an approval process? If so, please provide details? Is the 99% confidence level appropriate? If not, please justify why?

In our opinion the rule described in ARTICLE 6 (1) (c) (ii) which allows to take into account inflows only if they are reported in accordance with 404 (1) (a) to (c) is too restrictive. Assets that are Level 2 in the Basel III framework should be counted as inflows (be it with a haircut) as long as this collateral is unilaterally and immediately available to cover outflows to any other counterparty.

Which Validation process?

The authorization/validation process for a reporting institution to use the internal model based method is not clear. It should be authorized for the calculation of own funds requirements for counterparty credit risk (Art.5(1)(a)). What does mean Art.5(1)(c): *'these approaches have been validated for the transactions and contracts or risk factors covered by this Regulation'*? Does it mean that there are two validations to be obtained by supervisor? Does it mean that the model should have been validated for the type of instruments/risk factors covered by the RTS?

Delete over-penalizing unjustified restrictions on collateral mitigation value:

The restriction in Article 6(1)(c)(ii) that only additional inflows of extremely high liquidity can be recognized outside of margining sets does not make any sense, neither economically, nor within the LCR framework.

We urge EBA to delete this restriction as described below:

- *Art. 6(1)(c)(ii): The inflow of collateral is a liquid asset as reported in accordance with Article ~~404~~ 416(1)(a) to ~~(e)~~ (f) of Regulation xx/xxx [CRR, unless excluded according to Article ~~404~~ 416 (2) or Article ~~404~~ 416 (3) of Regulation xx/xxx [CRR].*

The avalanche of regulations that require collateral creates a 'collateral famine' creating a huge demand for collateral that may exceed the available collateral. That is the reason why it is important that eligible collateral is not overly restricted, directly or indirectly by this type of over-penalizing treatment.

As the avalanche of regulations is happening, collateral management is changing or is expected to change to accommodate for all the regulatory-driven changes. The effect of the restriction on current collateral management practice is irrelevant for a regulation that will apply for the foreseeable future.

Retain Expected Liquidity Outflows rather than Unexpected Liquidity Outflows:

In the Expected Positive Exposure (EPE) model from which the suggested internal model is derived, the *expectation* over the *positive* exposures is considered, *not a percentile*. This is conservative as only positive exposures are considered, then averaged. For potential liquidity outflows, this should translate into considering the *expected* potential liquidity *outflows*. There is no reason to adopt a percentile approach for liquidity that is not applied to counterparty risk.

We recommend that the internal model is based on Expected Liquidity outflows, rather than Unexpected Liquidity Outflows.

Should an Unexpected Liquidity Outflows be retained (as explained this method should first be adjusted to consider only the scenarios consistent with the LCR framework), the 99% threshold should be lowered and maturing deals within 30 days excluded:

Moreover, we consider too conservative the scenario that corresponds to the 99% confidence and we favour the percentile 80%. This reduced level allows taking into account the lower correlation existing between the movements of the market risk factors (except for the credit derivatives) and the liquidity crisis, than the one existing between the liquidity crisis and the actors' behaviours having an impact on the funding instruments (deposits run-off, drawdown on credit and liquidity facilities etc.).

Final calibration of the shocks and methodology:

In terms of final calibration of the method and of its parameters, we urge EBA to use the LCR observation period to conduct Quantitative Impact Studies on the proposed methodology. Without those QIS's, EBA could not estimate the cost/benefit analysis (please refer to our response to Question 24).

Q16. Please provide details of what adjustments in the implementation of your EPE model to be considered for the estimation of additional collateral outflows?

To be used for liquidity purposes, the scope of the existing EPE models will have to be expanded in order to include the derivatives cleared through a CCP (futures for instance). Moreover, currently the internal model based exists only in corporate and investment banks, where the derivative portfolios are material. Considering the costs and the modeling capabilities required for the implementation of such a model, it will not be deployed within the group. However, the advanced approach could still be used for the entities which offset their derivative positions. Then some adjustments will be necessary to ensure the calculation of the additional outflows at the solo entity level.

Q17. What are the expected implementation costs of the EPE based advanced method and what is the time you would need for implementation? If possible, please compare it to the implementation costs of the other methods.

The costs (mainly IT) and the time needed for the implementation of this approach are not expected to be neutral.

Q18. What impact in terms of liquidity coverage requirement do you foresee of the application of the internal model based method on your institution?

The first simulations show that the internal model approach lead to additional outflows between 2 to 3 times more than the standard method when excluding operations that matures during the 30-days horizon: which does not make sense.

The explanation is clearly related to the fact that the underlying scenario requires some adjustments to be consistent with the LCR assumptions during liquidity crises and is also due to the retained quantile (99%) which is too severe.

UNE simulations take into account repos that are under margin requirements. It is currently not possible to exclude repos and we do not think it make sense to exclude

them. Should they be excluded, we plead once again, for a better harmonization of the hypotheses of the current proposal with the LCR framework.

In terms of final calibration of the method and of its parameters, we urge EBA to use the LCR observation period to conduct Quantitative Impact Studies on the proposed methodology. Without those QIS's, EBA could not estimate the cost/benefit analysis.

Q19. How would you view the development of a method based on VaR for the purposes of estimating additional collateral outflows? Could you review this in the context of the abovementioned difficulties?

We consider that VaR is a valid process to elaborate on to derive additional liquidity outflows for collateralized transactions.

Under our proposal to calculate the additional liquidity outflows under the assumption of constant level of risk, to calculate the liquidity outflow at 1 day horizon and to derive the 30 day liquidity outflows by a scaling operation, the adjustments could be implemented in the Value-at-Risk calculation process as well.

The main adjustment to VaR would then be:

- including collateralized transactions that are not captured so far, such as listed market (futures) and cash transactions (ex: repos/reverse repos) if they are covered by this RTS;
- taking into account contractual arrangements that can affect additional collateral outflows such as one-sided collateralization, minimum transfers;

... and the accompanying mitigation effects of the collateral to be received/posted with their LCR-liquidity value (rather than market values).

Q20. Do you foresee any difficulties in calculating the consolidated estimates? If so, what are these difficulties and why do they arise? How material are they? What would be an appropriate alternative treatment?

It will not be difficult to calculate the consolidated estimates as the aggregation of the estimated additional outflows of the solo entities, but we think that this treatment does not make sense economically.

Indeed, the proposed methods may lead to estimate that two solo entities would both experience outflows on the same intra-group transactions. On the solo entities level, this makes sense, but on the consolidated level, the aggregation does not reflect the actual liquidity risk experienced by the Group.

Moreover, it is not clear whether entities outside the EU should also calculate an additional collateral need based on one of the 3 methods proposed by EBA. We think that on these entities, only external derivatives should be taken into account and for the consolidation only, as these entities are not submitted to CRR, and that the taking into account of internal operations does not make sense when dealing with the consolidated situation of the Group.

Then since those entities do not need to build up a liquidity buffer locally, they would not satisfy the threshold of the simplified method. We propose at least that the threshold applies on the liquidity buffer size that the head-office is holding on behalf of the entity.

In addition, the approach proposed by the EBA will penalize banking groups having a centralized management of their collateral even though this organizational model generally tends to reduce the operational risk within the group.

So, we strongly advocate a specific consolidated calculation excluding intra-group transactions that would make sense economically and then strengthen the liquidity risk management.

In terms of final calibration of the method and of its parameters, we urge EBA to use the LCR observation period to conduct Quantitative Impact Studies on the proposed methodology. Without those QIS's, EBA could not estimate the cost/benefit analysis

Q21. How would you like to see the historical look-back approach calibrated? Please provide details together with a justification. Should the method be focused on calendar months or utilize a moving 30 days window? Should the method be based upon full calendar years or be moving with a 24 months window?

The method should be consistent with Basel Committee on Banking Supervision's proposal: maximum observed change over 30 day period, over the last 24 months.

Q22. Is the method sufficiently resilient against potential future changes in volatility and against potential future changes in the size or characteristics of a bank's derivative portfolio? If not why and how could any such deficiency be addressed?

It is consistent with BCBS's proposal that non-European institutions will be subject to.

We agree that the historical approach is a backward looking approach. However, as it is based on the actual most adverse observation, there is no lagging effect: an increase in actual liquidity outflow will be considered in the 30 days after they materialize.

In terms of final calibration of the method and of its parameters, we urge EBA to use the LCR observation period to conduct Quantitative Impact Studies on the proposed methodology. Without those QIS's, EBA could not estimate the cost/benefit analysis.

Q23. Do you agree with our analysis of the impact of the proposals in this CP? If not, can you provide any evidence or data that would explain why you disagree or might further inform our analysis of the likely impacts of the proposals?

We agree to say that the costs should concern the entities which have to implement the most sophisticated methods (standard and internal model-based). In most of the cases these entities will also have material derivative portfolios justifying the implementation of those methods.

However, because of the restrictions on the use of the simplified method and due to the fact that this method does not take into account any netting effect, some entities will be obliged to opt for the standard method even though their derivative portfolios do not generate a significant liquidity risk (this is the case for the entities which derivative positions are in back-to-back for instance). For these entities, the implementation costs will be substantial but will not necessarily lead to a better liquidity risk management.

Moreover, there is simply no impact assessment of the suggested methodologies, on their consequences on European banks for their LCR and in terms of competition vis-à-vis non-European banks that will not be subject to this requirement, and on the consequences on the European banks' financing capacities.

In terms of final calibration of the method and of its parameters, we urge EBA to use the LCR observation period to conduct Quantitative Impact Studies on the proposed methodology.