



## POLISH BANK ASSOCIATION

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European Banking Authority

**Polish Bank Association Response to 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 on the institution's derivatives transactions, financing transactions and other contracts for liquidity reporting under Article 411(3) of the draft Capital Requirements Regulation (CRR) (EBA/CP/2013/19)**

Dear Sirs,

Polish Bank Association 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).

### **General Remarks**

The definition in the CRR Article 423 (3) (potential collateral outflows resulting from a negative market scenario for derivatives and repos) should make reference only to "margining set" of derivatives/repos transactions (therefore subject to payment of additional collateral in the event of a loss in value of the derivative/repo), hence it might be important to express explicitly in the RTS that "only" the derivative/repos subject to margining set enter into the scope of the analysis for regulation purpose. It would be useful if EBA adds the definition of "margining set" in the regulatory technical standard.

The draft RTS does not allow the institutions to combine methods for calculating their additional outflows and to revert from the use of a method to the use of another less sophisticated approach; which seems very restrictive. The banking sector strongly urges for more flexibility on this matter, especially since the total amount of additional liquidity buffer can be considered as high in comparison to the actual expected outflow. The methods proposed by the EBA are based on the underlying principle that the less complex methods are, the more conservative estimates of additional outflows they produce. Consequently, it does not seem necessary to add more restrictions.

#### *Simplified method*

The banks are not in favour to restrict the use of this method exclusively to the entities for which the calculated additional outflows do not exceed 5% of the liquid assets reported by the entity. It is additional limit and it can be important when this method is treated as straightforward for banks. Indeed, among the three approaches presented in the draft RTS, this simplified method will be, by far, the fastest one to implement. Considering the costs and the time necessary for the implementation of the two other methods, most banks will not be ready in time to calculate their additional collateral outflows if they are not authorised to use the simplified approach.

In our opinion the conservative method of calibration of the shocks proposed in the simplified method should be sufficient incentive to institutions to apply, as soon as they can, for a more sophisticated approach.

However ,the simplified method creates important methodological concern due to the fact that it does not take into account any netting effect. By selecting only the larger of the notional values, 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 has entirely hedged its positions, this will lead to the calculation of additional collateral outflows which economically would not be justified. 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*

The implementation costs of this method are expected to be generally higher than in simplified method because this one will require developing valuation tools in each bank. Standard method will be another modelling approach that banks have to implement in risk management.

#### *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 the institutions to reduce their sensitivity to market risk factors on collateralised derivatives.

Furthermore, the advanced approach has the advantage to be based on the existing models and valuation tools used to calculate the capital requirements for the counterparty credit risk. This should reduce the implementation costs for the institutions and optimise the validation process of the models as well as the supervision by the national authorities.

**Response to Questions for Consultation:**

**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?**

Basically banks do not see the types of contracts which might lead only to immaterial additional outflows for an institution.

The notion of “materiality” would require a more precise definition.

**Q.2 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 criteria presented in paragraph 2 are quite clear. However, banks ask for clear presentation of conditions which shall be met by banks in order to use the standard method or the simplified method.

**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.**

Banks which responded to us regarding the EBA consultation do not indicate any other reason than decline in value of the collateral and of course the change of assessment of contract value.



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

In opinion of banks the proposed paragraphs are sufficient in order to reduce mentioned behaviour.

**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?**

In opinion of banks the standard method takes into account all aspects and the scenarios in annex 1 are appropriately calibrated. However, it would be helpful to understand what is the rationale behind the mentioned scenarios and whether these changes of risk factors have ever been observed in the past.

**Q6. What 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?**

In our opinion the proposal of the standard method captures these assets adequately. The derivatives of banks are sensitive to risk factors described in annex 1.

**Q7. How do you view the restriction in paragraph 3 that only additional inflows of assets of extremely high liquidity and credit quality 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?**

The collaterals used by Polish banks are generally securities and money. These kinds of collaterals are assets of high liquidity and credit quality. The assets of lesser liquidity are not significant in total value of collaterals.

We understand the meaning of this restriction but it seems important to highlight that such a restriction will significantly increase the demand for collateral of high liquidity and credit quality and then can contribute to the top-collateral crunch.

**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 the capability to calculate NPV sensitivities, which is never straightforward even for experts.

Since activity in every currency requires a single scenario, an utmost number of scenarios must be calculated. This attitude requires significant investment in IT bank infrastructure. Due to the specific requirements of this RTS this calculation must be set up in addition to scenarios currently used by banks and can not re-use results of internally used models.

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

The substantial amount of outflow calculated according to the standard method can contribute to higher level of liquid assets which are necessary in banks.

**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?**

Polish banks generally conclude transaction in Polish zloty and currencies as EUR, USD or CHF. Nowadays Polish zloty is not yet in the ERM II. The transactions of Polish banks in currencies which are in the ERM II are marginal and do not have significant impact on the liquidity risk position. However, in our opinion it is reasonable to introduce lower shock factor for currencies in the ERM II in relation to EUR. We have to mention, that 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. 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. In order to take into account compulsory intervention rates, an appropriate shock factor would be 2.25%.

**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 they be calibrated, justifying your proposal?**

The banks in Poland ask for clarification if the simplified method shall be used separately for all currencies or shall be calculated only the aggregated value of potential outflow for transaction in all currencies.

**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.**

The banks in Poland reported to us that they are ready to use this method without high additional cost. Among the three 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 its implementation are not expected to be high. The banks estimate the time for few months.

**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?**

The substantial amount of outflow calculated according to the simplified method can cause that the higher stock of liquid assets will be necessary in banks. It will generate additional cost for banks.

**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 generally to the answer of the Question 10. Banks in Poland do not conclude transaction in currencies which are at present in currency peg of the ERM II.

**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 CRR Article 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.

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

No comments to this question. Many banks do not use the EPE model.

**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.**

Please refer to the answer of the Question 16.

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

Please refer to the answer of the Question 16.

**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?**

In principle the VaR model could provide adequate day-to-day risk management information for margining liquidity risk. But this needs to be embedded into a prudent stress testing regime to better assess wrong way risk, collateral triggers, change of external parameters like changes in margining requirements of CCPs.

Keeping in mind such adjustments, VaR models could be considered as a valid alternative to standard methodology that for sure would imply many efforts particularly in terms of implementation costs.

Taking into consideration the general logic of CRD IV it is doubtful if the method based on VaR is appropriate for the purposes of estimating additional collateral outflows. We recommend to use stress-test.

**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?**

Some banks see difficulties in calculating consolidated estimates with respect to implementation of CRD IV rules in entities belonging to the group.

**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?**

In our opinion the method should be based on the sums of net outflows in the LCR horizon of 30 days and the impact shall be assumed on every day during the last preceding 24 months.

The historical look back over 24 months could provide an appropriate floor for outflow estimations which should justify using the historical look back method by bank. This method could be used during the transition period until bank replace it by either the simplified or standardized methodology.

**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?**



The method seems to be quite resilient against potential future changes in volatility. The window of 24 months should allow collecting the dates from different points of economic cycle.

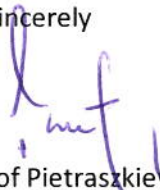
**Q23. Do you agree with our analysis of the impact of the proposals in this CP? If not, can you provide any evidence or data that would explain why you disagree or might further inform our analysis of the likely impacts of the proposals?**

We do agree with the analysis.

We think 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.

Yours sincerely



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President