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*Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of some 4,500 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU alone.*

## **EBF Draft Response to EBA consultation on Draft Regulatory Technical Standard 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) (EBA/CP/2013/19)**

The EBF 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 below.

### **General Remarks**

#### *Need for a specific consolidated treatment*

The methods proposed by the EBA which allows obtaining an assessment of the additional collateral outflows 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 the institutions estimate the additional collateral outflows at a group level by aggregating the outflows calculated on the solo entities. EBF Members are 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, the EBF strongly supports a specific consolidated calculation excluding intra-group transactions that would make sense economically and then strengthen the liquidity risk management.

Presumably additional outflows at consolidated level are not the mere sum of outflows at individual level, but the result of simulations at group level that do not include intra-group deals and take into account correlations, if granted by the chosen method, within the same risk factor and between risk

factors. However, in case of application of different approaches within the same banking group, the methods of aggregation should still be established.

Even at individual level, intra-group deals could have a preferential treatment with regard to different business models adopted. In the event that the group business model provides for a unique investment bank that operates for the whole Group, closing transactions back to back with the market, these back to back transactions should be properly accounted for in the model without double counting.

#### Need for alignment with the LCR

In the LCR, the numerator and denominator are closely interlinked, and it is not logical to look only at the denominator without taking into account the impact on the numerator and vice versa. The proposed RTS does not always follow this logic, requiring higher levels of aggregate liquidity buffers. Take for example, an institution that is sensitive to interest rate decreases which will see an increase of the market value of debt securities in their liquidity buffer (HQLA) when interest rates decrease. This will partly offset the collateral outflow due to interest rate decreases and therefore should be included as an inflow. Another discrepancy is that inflows can only be taken into account if they consist of HQLA assets, whereas *all* outflows are taken into account.

#### Scope of analysis

Although 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 “marginied” derivatives/repos transactions (therefore subject to payment of additional collateral in the event of a loss in value of the derivative/repo), it might be important to make explicit in the RTS that “only” the derivative/repos subject to margining enter into the scope of the analysis (and should therefore exclude all derivatives/repos that are not subject to margining). It would therefore be beneficial if EBA were to carefully include the definition of ‘margining sets’ in the RTS, to allow for independent reading of the RTS. In this context, it is also not clear why article 2(1)d requires institutions to determine the gross amount of additional outflows by adding together all value decreases resulting from the re-valuation of point 2(1)c.

#### Need for more flexibility in the choice of the methods

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. This seems very restrictive. The EBF strongly urges for more flexibility on this matter, especially since the total amount of additional liquidity buffer requirements is considered steep, compared to the actual outflows that are to be expected.

Indeed, 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.

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

It is hoped that there is full consistency between credit and liquidity risk perimeters, to avoid that the “partial” validation of an advanced credit model (e.g. “partial” since limited to some legal entities of a single banking group) could lead to the inapplicability for liquidity purposes at group level (and between individual legal entities within the group). Additionally, some EBF members are in the process of a phased implementation of the IMM approach for credit risk purposes. Not allowing those banks to use the more sophisticated model – even in case they have approval from their national competent authority to use the internal model for credit risk purposes - seems undesirable. It is therefore requested that the principle of “no combined use of the proposed methodologies” is removed. A partial use of different approaches (in coordination with the national supervisory authority) is from our point of view the most appropriate approach to support the use of the more ambitious methods.

#### Historical look back approach as a back stop

Due to highly conservative assumptions used in building scenarios (extremely high confidence level, high percentages of shock, prudential treatment of inflows, different degrees of inclusion of diversification and correlations, etc), the three methods proposed (simplified, standard and advanced/UNE methods) could lead to results excessively harsh and far from the historical observations. For this reason, the methodology introduced by BCBS in January 2013 could be used as a benchmark to define the maximum amount of loss in all the three methods.

#### Specific remarks on the different methods mentioned by the EBA

##### *Simplified method*

The EBF does not plead for restricting 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.

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 European banks and their subsidiaries will not be ready in time to calculate their additional collateral outflows if they are not authorised to use the simplified approach.

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

However, there is an important methodological concern with the simplified approach 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*

First of all, the implementation costs of this method are expected to be generally higher because it will require developing valuation tools, as the standard method would be yet another modelling approach that banks would have to implement in each entity. Therefore, we suggest EBA consider allowing banks that have approval to use a VaR model to also use this model (potentially updated to fit the specifications of this CP) for calculating additional outflows on derivatives in each entity.

Furthermore, 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, EBF Members do not favour shocks based on the hypothesis of a 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.

Although the EBF understands the EBA's choice - for the sake of curtailing complexity - not to include the impact of correlations and diversification effects, these should be incorporated in the standard method in order to make the results more realistic.

### *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. However, the proposal is not specific on the use of internal models in case an institution has a supervisory approval to use an IMM model for a significant part of its portfolio. The RTS should recognise the supervisory assessment in regards to partial use and should therefore only require banks to apply the internal model method to the part of the portfolio where they have supervisory approval. Such an approach would also tackle any issues in regards to phased migrations towards IMM compliance.

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.

However, EBF Members consider the scenario that corresponds to the 99% confidence interval too conservative and favours the 95% percentile. This reduced level would take into account the lower correlation existing between the movements of the market risk factors (except for the credit derivatives) and a liquidity crisis, rather than the one existing between liquidity risk and the actors' behaviours having an impact on the funding instruments (deposits run-off, drawdown on credit and liquidity facilities, etc).

Another approach could be the percentile level calibration through the historical look-back approach.

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Related documents: <http://www.eba.europa.eu/documents/10180/205409/Draft-CP-on-RTS-on-additional-collateral-outflows---final-to-be-published.pdf>

**Response to Discussion 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?**

Basically the mentioned contracts might lead to additional outflows for an institution. However, additional liquidity requirements for instruments where already an initial margin (e.g. trades with CCP) has been provided will suffer a double counting of collateral. These contracts should be excluded from the additional collateral requirements according to CRR Article 411 (3), since the initial margin serves the purpose of CRR Article 411 (3) already. The initial margin of the CCP is tailor-made for these contracts. Alternatively, the initial margin should be deducted in the calculation of the additional collateral requirement.

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 specification in paragraph 2 is quite clear regarding points a), c) and d), but calls for clarifications regarding b). Indeed, the wording of 2b) seems to us subject to interpretation.

The indication in paragraph 2 (b), “institutions shall not include outflows or inflows that result from value changes in collateral posted” seems to exclude from scope an ordinary repo where a collateral call would only be triggered if the value of the bond decrease. This effect should be already taken into account by CRR Article 423 (1) “Additional Outflows 1. Collateral other than assets referred to in Article 416(1)(a), (b) and (c), which is posted by the institution for contracts listed in Annex II and credit derivatives, shall be subject to an additional outflow of 20 %.” In Annex II a list of derivatives contracts is reported, however there is no specific mention of SFTs. If SFTs are not included in the list that would mean that changes in the value of collateral posted for SFTs are not taken into account at all.

Excluding the SFT which underlying is a liquid asset as per CRR Article 416 is relevant, since the CRR 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 CRR Article 423 (1).

However, EBF Members strongly favour a consistent treatment and a harmonisations 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 SFT with an equity underlying, the outflow factor to be applied according CRR Article 423 (1) 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.

It would be helpful if the EBA could provide some examples that illustrate the interaction of the LCR positions “Net known derivatives payables/receivables and the additional liquidity outflows corresponding to collateral needs defined in this consultation paper e.g.:

1. short call option on a non-financial major index company, out of the money (strike 100, underlying 80), maturity within 30 days, provided initial margin 5, calculated potential liquidity outflow from adverse market scenario: 7
2. same as 1, but in the money (strike 100, underlying 120).
3. same as 1, but maturity > 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 suggested collateral outflows from securities financing transactions seem to be related to a decline in value of the collateral posted particularly due to interest rate and credit spread changes, in particular for long term repo. An exception could be the change in value of Long Term Repo backed by floating assets in case of a change in interest rates.

**Q4. Are paragraphs 2c and 2d sufficient for reducing incentives for cherry picking behaviour? 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.

Furthermore, due to the fact that for adopting the UNE method one of the conditions required is the permission by competent authorities to use advanced approaches for counterparty credit risk, we think that, in contrast with what is reported in Article 5 (2) there should be full consistency between perimeter of application for credit and liquidity risk purposes. In particular, we do expect that different methodologies could be adopted inside a banking group, where some institutions could choose less sophisticated approaches and some others the most advanced ones, if the advanced approach for credit risk were validated only for those legal entities.

Paragraphs 2c and 2d seem counterproductive, since it hampers a stepwise transition from the simplified to the standard method and from the standard to the UNE method. Furthermore, materiality thresholds should be taken into account of specific risk factors and derivative products.

A partial use (in coordination with the national supervisory authority) is from our point of view the most appropriate approach to support the use of the more ambitious methods.

Also, 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) which trades some of its derivatives with another intra-group entity (B), having implemented the internal model method. Indeed, B could provide to A the valuation through the advanced approach of the transactions traded between them two. For the remaining stock, A could use the simplified approach.

This combination of two 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 according to paragraph 2c, this approach is not possible and the entities will have to develop with substantial costs the standard method which is less sophisticated.

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

**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?**

It would be helpful to understand what the rationale behind the mentioned scenarios is and whether these changes of risk factors have ever been observed in the past, as they appear to be very conservative. Fixed interest rate shifts like 130bp (OECD countries) and 230 bp (non OECD countries) within 30 days do not seem appropriate for the current trade cycle phase with yields close to zero.

The scenario for interest rates above 10years is unclear. It is mentioned "a flat curve is assumed." Does this mean that there are no changes in rates, or do the same change apply as for 10years (i.e. +/- 100 for OECD and 150 bp for non OECD countries)?

Regarding other risk factors, it should be made clear, that risk factors like volatility, which are expressed as a percentage do not increase/decrease by an absolute shift of +/- 20% but are rather subject to a relative shift (e.g. 25% volatility will be shifted to 30% and 20% respectively.)

The scenario related to the foreign exchange rate risk factor would also require some clarifications. 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 and top 3 most important currencies occur simultaneously? In both cases, a numerical example would be highly appreciated.

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.

The assessment of the impact on the contract's value resulting from a two or three notch 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 would be 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.

**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?**

All options are affected by multiple risk factors. For example consider the equity option and the price and volatility of the underlying. The standard method neglects the interconnection of volatility and underlying price/rate. Volatilities and the shift of the risk factors of the underlying should therefore be combined (the interest rate shift and volatility shift should be combined rather in one scenario than in two independent scenarios).

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

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 contribute to the phenomenon of top-collateral crunch.

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 CRR 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.

Transferable assets that are of high liquidity and credit quality according to CRR Article 404(1)(d) should be considered too.

**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 straight-forward even for experts.

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

The RTS should allow to combine some risk factors (as mentioned in Q6). Furthermore, it should be allowed to calculate the required results by sensitivity analysis and omit full revaluations for every risk factor. Especially, if derivatives are used for hedging purposes or back to back trades only, an excessive number of scenarios should be avoided. Immaterial currencies should be combined in one single scenario.



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

Since the correlation of different risk factors is completely neglected, the calculated results of a well balanced portfolio with highly correlated currencies (e.g. EUR and DKK or NOK and SEK) will show inadequately high results.

**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. In order to take into account compulsory intervention rates, an appropriate shock factor would be comprised of 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 method does not seem appropriate for banks, which trade derivatives on a back to back basis only for the purpose to accommodate customer demand. This business should be excluded from any additional collateral requirements.

Specifications of the simplified method could be completed by some practical examples allowing to identify the expected reporting of vanilla rate derivatives such as basis swaps (exchange of two floating rates in the same currency) and cross currency swaps for instance.

Moreover, there is an important 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 trade 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.

**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 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 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?**

The 5% threshold is low and consequently rules out many institutions from applying it. On the basis that the simplified method is a conservative methodology, there is a case for a significantly higher threshold than the 5% indented.

Please also refer to our answer to Question 23 and page 3 paragraph on “Simplified Method.”

**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?**

Article 6(1)c, in conjunction with the explanatory remarks, could be misinterpreted as this article pertains to anything else except re-usability of the collateral. Based on the discussions during the public hearing, the scope was confirmed to apply to re-usability only. We therefore request EBA to reword this section in order to clarify the scope.

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.

Moreover, we consider the scenario that corresponds to the 99% confidence level too conservative and we favour the 95% percentile. 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 a liquidity

crisis, than the one existing between the liquidity risk and the actors' behaviours having an impact on the funding instruments (deposits run-off, drawdown on credit and liquidity facilities etc.).

We further require clarification with respect to Article 6 (1) (b) (ii) ("For the purposes of this calculation any single transaction or contract not part of a margining set shall be considered as a margining set of its own.") since we do not understand the usage of the term margining set in this context: On occasion collateral agreements are established for individual transactions, particularly if valuation disputes exist with the counterparty on a single or a handful of trades. Obviously these single transactions are then margined separately via the separate collateral agreement. In addition, there could be trades or products within the total trade population which (for various reasons) are not covered by the collateral agreements e.g. IR and FX products are covered but CDS products are not part of the collateral agreement. In the sense of the above these are not part of the margining set but it does not make sense to create an own margining set for them since those transactions are not collateralised at all.

We are concerned that the initial margin used with central clearing counterparties (CCP) might impose unwanted complexity and heavy calculations for the advanced method. We expect EBA to advise how to perform the calculation using approximating methods to avoid having to model the VaR calculation performed by the CCP.

The text says, "if collateral is received on any of the transactions or contracts within the set it can be fully and immediately used to...". We question the word "immediately" and suggest replacing it with the term "available" to reflect the timeliness in the collateral process. In addition, EBA could clarify that the intent of the text is simply to secure that the collateral received is available for re-hypothecation.

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

UNE method will require some adjustments in the EPE model to for example take into account negative market shocks and different time lags. As regards to SFTs, the EPE model includes the change in value of the collateral posted. The model needs to be further improved to avoid this kind of effect. However, the cost of such adjustments seems to be much lower than the implementation from scratch of the other methods.

Furthermore, 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). Further EPE models should:

- Extend IMM model coverage to all trades as defined by CRR Article 411.
- Be enhanced to set up required statistical methods to analyse cumulated collateral paths for each margining set.
- Extend aggregation layer for additional margining results.

Moreover, currently the internal model based approach 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 entire groups. 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.**

Given the high complexity of the IMM model infrastructure one banks estimates that it would require a minimum 6 month project for implementation. The additional necessary planning processes cannot be started before legislation has been finalised.

However, having an approved credit model in place, the implementation costs of the UNE method are much lower than those required by the other methods.

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

Clarity over the exact impact will not be available until the actual model has been implemented. However, even though we do not have yet any evidence, we do expect a relevant impact in terms of LCR if some important adjustments, in terms of confidence level, back stop clause, management intervention etc., are not taken in due consideration.

**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.

However, some EBF Members find that EPE models are more appropriate to meet the needs in terms of additional collateral outflows. Moreover, they agree with the EBA to say that the necessary changes to adapt the current VaR models of the institutions will be huge and will involve higher implementation costs than those expected with the use of existing EPE models. Consequently, these Members do not support this method.

**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 EBF Members will see difficulties in calculating consolidated estimates with respect to different legal entities which will adopt different methodologies. How to sum up the results? How to consider intra-group deals? How to split the results by different currencies, countries and business units (in case the approach is taken as a tool for defining transfer prices)?

However, the EBF does not believe that a simple sum of results could make sense economically. 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 a 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.

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

**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?**

Some EBF Members note that a key limitation with quantifying additional liquidity outflows with historical data is that it may not represent the risk attached to current positions and operational arrangements. As such, this may not be the most appropriate method to capture additional liquidity outflows. For example, a bank could sell the majority of its derivatives book and yet still has to hold excess liquidity while another bank may be growing its derivatives book yet the historical method would not capture this forward looking risk. A historical approach would not capture any "black swan" events.

However, if a historical look-back approach is to be used then it could be focused on calendar months (maybe adjusted to consider the right LCR horizon, that is 30 days starting from the end of month) with a 24 month window. The exercise could be extended to a particular period of stress that could be different from the preceding 24 months, if the presence of historical observation data could support such analysis.

The historical look back over 24 months could provide a floor on outflows with institutions allowed to use the historical look back method for a period of time as they transition to either the simplified or standardised 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 too resilient against potential future changes in volatility. In particular, the regulatory confidence level (99%) could appear overly conservative in relation to what has happened in the past, even during a period of stress. The historical look-back approach could be used to calibrate it. Furthermore, some adjustments should be taken into consideration to introduce some hypothesis of

managing intervention in one month or changing in derivatives portfolio in particular for trading activities.



**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. Even though we do not have yet any empirical evidence, we feel that the impact in terms of LCR will be huge, regardless of the method adopted. Also for this reason a “back stop clause” based on historical internal data series would be welcome.

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 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.

