EBA/CP/2013/19

European Banking Authority
Sent by email to: EBA-CP-2013-19@eba.europa.eu

Re: 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)

Dear Sirs

HSBC Banking Group appreciates this opportunity to respond to the European Banking Authority regarding its discussion Consultation Paper on "Additional Liquidity Outflows Metrics under Article 411(3) of the draft Capital Requirements Regulation (CRR)". HSBC understands the objective of the paper and supports the proposed EU common reporting framework for liquidity.

A. General Comments

Whilst we appreciate and support the EBA's goal to better manage the risk associated with liquidity of derivatives in general and the reporting thereof, we are concerned around the timing of implementation given systems requirements and the interaction of different calculation methods given the models that are proposed. There is a concern that the amount of resources required to calculate the risk of derivatives bears no resemblance to the actual liquidity risk associated with derivatives for many institutions and therefore may possibly divert both resources and attention away from the monitoring and management of real liquidity risk. For many of the questions posed we are not currently able to assess the precise impact due to the embryonic nature of the stress requirements and the lack of precision around the interaction of the models, we therefore would suggest a Q&A requirement will need to be instigated to aid speedy and effective implementation.

B. Timing of Implementation

As the scope of the requirements around this reporting for an EU lead regulated bank is both at single entity and consolidated level, this requires a global financial services group, such as HSBC, to implement in many jurisdictions across the globe. We are committed to undertaking just such a requirement, with the ongoing commitment to report both LCR and NSFR on this basis. We believe that calibration of any derivatives calculation of liquidity outflows should be driven by a well thought through strategic and automated solution rather than a counterparty credit risk model that has been adapted for the purposes of liquidity; this may take a number of years to implement. In the meantime we think it should be possible to undertake a more simplified method that does not divert material resources away from overarching requirement to manage liquidity and funding risk and yet materially captures the risk position.

C. Scope of Requirements

Conceptually HSBC is opposed to the use of consolidation for liquidity metrics. With regard to LCR and NSFR metrics we can understand the attraction of consolidated reporting for supervisors. Within the proposed calculation methodologies we are concerned that different methodologies will be required to be implemented in different jurisdictions given that the EPE method as proposed can only be used where official regulator sign-off has been approved. These methodologies will need to be consistent to ensure that there is not a double count of liquidity outflows between entities within the same group who are being required to implement different models.

D. Response to questions posed by EBA

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 notion of materiality is only relevant to each individual entity and will depend on their specific business model/products which are then driven by price volatility of the underlying risk factors

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

HSBC believes this is clear.

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

HSBC has no specific comment here apart from to ensure any collateral outflows on securities financing transactions are treated consistently with CRR Article 418.

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

Yes. We would however like to get more clarity on what model to use if a product is not signed off by the regulator in a list of Approved Products and which model is used when and EPE model does actually model a specific product.

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 1 appropriately calibrated? If not, how would you suggest improving calibration?

HSBC has no comment to make on this question at this time

Q6. What instruments transaction 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 quality liquidity and credit quality as calculated in accordance with Part Six of CRR? Does the standard method capture these adequately? If not, what alternative would you consider necessary to ensure they are appropriately incorporated?

Many instruments are sensitive to changes in multiple risk factors, but we think deliverable Cross-Currency Basis Swaps are the material products.

Q7. How do you view the restriction in paragraph 2, point h(ii) that only additional inflow of extremely high liquidity can be recognized 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 think inflows of assets should be entirely consistent with the LCR definition of liquid assets, with appropriate haircuts. Assets outside of extremely highly liquid assets are not material for HSBC.

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 cost of the other methods.

We expect one-off implementation of these methods to be $10-$50 million, depending on the interaction of the methods and further ongoing run the bank costs. The look-back approach would be a minimal cost.

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

HSBC is unable to fully calibrate an answer to this question at this time due to the lack of clarity around intra-group flows and model interaction in different entities.

Questions 10-14 inclusive.

HSBC has no comment to make on these questions

Q15. Are there any aspects of the advanced method based on EPE 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 described in annex II appropriately calibrated? If not, please describe how they should be calibrated, justifying your proposal?

The parameters within the EPE model should, as much as possible, be consistent with the LCR stress. We believe for liquidity modeling firms should be able to apply the internal-model base approach for those Approved Products, even though this may not encompass all products traded.

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

HSBC has no comment to make on this question

Q17. What are the 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 other methods.

HSBC has no comment to make on this question

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

HSBC is unable to fully calibrate an answer to this question at this time due to the lack of clarity around intra-group flows and model interaction in different entities.

Q19. How would you view the development of a method base on VaR for the purposes of estimating additional collateral outflows?

HSBC believes a VAR based method is not the effective and risk sensitive method of calculating the liquidity risk associated with derivatives as the driver of liquidity risk of derivatives normally comes from the mitigation of counterparty credit risk.

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?

HSBC believes that if different models are implemented in different jurisdictions, then the methods used to calculate liquidity outflow and inflows must not produce double counting. Therefore the consistency of implementation will need to take into account these issues when considering Back to Back trades with different entities using different calculation methods and taking into account different collateralization agreements. This is likely to be a very challenging requirement. At the very least we believe it should be a requirement from the regulator to deliver a principle that double counting both outflows or inflows is not appropriate, in line with the full LCR calculation.

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 moving 30 days window? Should the method be based upon full calendar years or be a moving with a 24 months window?

We understand the look-back approach is certainly not risk sensitive and is pro-cyclical; however in the short term it could be used as an operationally tactically efficient way to understand the liquidity risk of derivatives before a more appropriate method is implemented. The position could be scaled up by any changes in the absolute size of the derivatives book or by a specific factor to as a proxy for risk. In our view the method should utilize a timescale consistent with the LCR and be based upon a moving 24 month window.

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

See answer to Q21.

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?

HSBC agrees with the proposal and the assessment that the higher the complexity the higher the costs. HSBC understands that substantial one-off costs are likely to be required to implement automated systems and therefore would request that basic back stop measures such as the look-back approach, which are operationally efficient, are implemented as a tactical solution. This will enable the appropriate IT solutions to be built and implemented alongside the more important requirements to implement the LCR and NSFR on a global basis.

HSBC Group appreciates the opportunity to share feedback and is happy to engage with regulators to further consider the issues around Additional Liquidity Outflow Metrics.

Sincerely,

Mark Sinclair (Group Head of Liquidity Policy and Control)