

21 March 2013

European Banking Authority  
Tower 42 (Level 18)  
25 Old Broad Street  
London EC2N 1HQ

United Kingdom

Submitted via: [EBA-DP-2013-01@eba.europa.eu](mailto:EBA-DP-2013-01@eba.europa.eu)

Re: **Discussion Paper: Defining Liquid Assets in the LCR under the draft CRR**

Dear Sir/Madam:

Markit<sup>1</sup> is pleased to submit the following comments to the European Banking Authority (the “**EBA**”) in response to its Discussion Paper on *Defining Liquid Assets in the LCR under the draft CRR* (the “**Discussion Paper**” or the “**DP**”).<sup>2</sup>

## Introduction

Markit is a provider of financial information services to the global financial markets, offering independent data, valuations, risk analytics, and related services across regions, asset classes and financial instruments. Our products and services are used by a large number of market participants to reduce risk, increase transparency, and improve the operational efficiency in their financial markets activities.

Markit has been actively and constructively engaged in the discussion regarding regulatory reform of financial markets. We regularly provide regulatory authorities with our insights on current market practice, for example in relation to valuation methodologies, the provision of scenario analysis, and the use of reliable and secure means to provide daily marks. We have also advised regulatory bodies on potential approaches to enable timely and cost-effective implementation of newly established requirements, for example through the use of multi-layered phase-in or by providing participants with a choice of means for satisfying regulatory requirements. Over the last two years, we have submitted over 40 comment letters to regulatory authorities around the world and participated in numerous roundtables.

Markit has, for many years, examined liquidity factors for financial instruments across various asset classes. Since 2010, we provide our clients with transparent, observable liquidity metrics and unique asset-specific liquidity scores that are derived from these metrics for 12 asset classes including bonds, Credit Default Swaps, Syndicated Loans, as well as Asset Backed Securities. On that basis we welcome the publication of the EBA’s Discussion Paper on *Defining Liquid Assets in the LCR under the draft CRR* and we appreciate the opportunity to provide you with our comments.

**Q1: Given the difficulties with obtaining transactional data outlined here, do you think a data sample cover 2008-2012 is sufficient for this analysis? Would you see merit in extending the sample in those countries where more data is available?**

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<sup>1</sup>Markit is a financial information services company with over 2,900 employees in Europe, North America, and Asia Pacific. The company provides independent data and valuations for financial products across all asset classes in order to reduce risk and improve operational efficiency. Please see [www.markit.com](http://www.markit.com) for additional information.

<sup>2</sup> EBA Discussion Paper: Defining Liquid Assets in the LCR under the draft CRR. 21 February 2013.

Based on our experience, we agree that obtaining reliable transaction data often proves challenging, particularly in the fixed income markets. However, we believe that even if the EBA was able to obtain only certain datasets for the period prior to 2008 it might be beneficial to include this data in the analysis as it represents the markets prior to the onset of the financial crisis. We believe that including data from different market regimes in the analysis will put the EBA in a stronger position to define liquidity and create a set of guidelines that is more likely to be applicable throughout time.

**Q2: Do you have additional data sources to suggest? Specifically, can you suggest a source of repo data and gold that would fit our needs?**

We support the EBA in its endeavour to identify additional data sources that might be useful in the context of measuring the liquidity of the relevant financial instruments. We believe that, to some extent, the EBA will be able to make use of existing initiatives to achieve this goal.

Over the years, Markit has built a track record for providing transparency particularly in the less liquid asset classes. In asset classes where transactions might not occur on a regular basis, the availability of data and quality of data is informative to the liquidity of the assets and the asset class. We have applied the wealth of our data to our pricing services throughout the various asset classes. On that basis, we have found that, in addition to transaction data, access to contributed prices, quotes, the number of overall data points, and the dispersion of data points are key parameters to understanding the liquidity characteristics of financial instruments.<sup>3</sup>

In relation to the repo markets specifically, Markit and other, competing providers have collected the relevant data over the years. The Markit Securities Finance data services, for example, capture a significant portion of the global repo markets through a combination of triparty and bilateral transaction data to provide security level information for repo collateral.<sup>4</sup> Importantly, our stock loan and repo data is cleaned, mapped, processed and aggregated by a large, dedicated team. We have also developed translators to allow clients to submit files in a wide range of formats and, in the process of processing the data, we routinely identify and address data and trade input errors. Additionally, providers of data services in these markets are experienced in ensuring that the resulting information is provided in a format that is most useful for its recipients, including regulatory authorities.

**Q3: Do you agree with the list of liquidity metrics under consideration to be used in the EBA assessment, as mentioned in this section and Annex 5? Can you suggest further metrics the EBA should make use of, where information would be available?**

We appreciate the fact that the EBA identified a number of relevant liquidity metrics. However, we recommend that the EBA undertakes further analysis of these issues and makes use of a more granular approach.

Firstly, the EBA proposed establishing an ordinal ranking of the liquidity of the various asset classes in question. However, in our experience it is not uncommon for asset classes to contain both very liquid and highly illiquid instruments.<sup>5</sup> We believe that the EBA should avoid limiting the use of very liquid instruments for the LCR only because they are part of an asset class that contains also many less liquid instruments. We therefore recommend that the EBA breaks down overall asset classes further into sub-asset classes with the objective of ranking those by their overall liquidity. We believe that such approach will result in

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<sup>3</sup> As well as price quality.

<sup>4</sup> While we have generally not collected stock lending non-cash collateral information in the past we are planning to start this later this year. This will be facilitated by our existing data links with the major triparty collateral providers.

<sup>5</sup> For example, the asset class of Euro-denominated corporate bonds might include both a recently issued benchmark bond of a EUR 5bn size and a EUR 50mm private placement.

providing a more accurate and representative picture of the liquidity of these categories of instruments while it would not need to result in an overly high number of categories.

Secondly, we believe that the EBA should take a more granular approach to the use of liquidity metrics. As part of our Evaluated Bonds offering, for example, we provide an objective Liquidity Score based on the following supporting liquidity metrics:

- The Number of unique dealers quoting the bond,
- The number of unique pricing sources observed per bond,
- The number of unique quotes observed per bond over a certain period,
- Market data liquidity merits,
- Bid / ask spread liquidity merits,
- Maturity liquidity merits,
- Bid / ask spread data per bond, and
- Fuel rankings to show the hierarchy of information used on the yield curve.

More specifically, we would propose the use of a parameter-based intra-asset class sub-categorisation based on a methodology that considers data histories for the following factors:<sup>6</sup>

- Historic bid / ask spread data for the asset,
- The average number of unique dealers quoting the bond (and/or trading venues),
- The average number of unique two-way runs of institution size,
- The average number of unique pricing sources observed per bond, and
- The average number of unique quotes observed per bond.

Based on this approach one can capture the willingness of market makers to provide liquidity for a particular instrument that could be used in conjunction with turnover data. This would be particularly useful for assets classified on the border of liquidity categories. We believe that, for example, for Level 2 and ineligible instruments the EBA is unlikely to be in a position to perform any broad and meaningful regression test based on the use of transaction data alone.

Additionally, we believe that the EBA should take into account that any set of clearly defined factors to make liquidity determinations is most valid only when the regime is established. However, there will be a need for the EBA to review the actual liquidity of the relevant asset classes thereafter, both on a regular and on an ad hoc basis, to determine permitted percentages for the LCR.

Finally, the EBA should note that, given the complexities of this determination, the use of expert judgment might often be necessary in developing a view on liquidity and how to measure it.<sup>7</sup>

**Q4: Do you agree with the list of explanatory characteristics whose linkage to liquidity is proposed to be tested in the EBA assessment? Can you suggest further characteristics the EBA should assess?**

We commend the EBA for identifying a whole range of relevant explanatory characteristics for the measurement of liquidity. We further appreciate the EBA's acknowledgement that different asset classes may have different explanatory characteristics for their liquidity.<sup>8</sup>

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<sup>6</sup> All such factors would be measured over a specified number of trading sessions.

<sup>7</sup> Expert judgement plays no part in Markit Liquidity Scores once the calibrations/ factors have been set; we intentionally keep it objective and let the data portray liquidity. However, to a degree expert judgment is necessary in choosing the score and determining the relevant weight for of each factor into the score.

<sup>8</sup> "The EBA has identified a set of general explanatory characteristics that it expects to have relevance across all asset classes, which can be further sub-divided into those that refer to market structure and those referring to the properties of an asset. The EBA

However, we also believe that within each asset class these and potentially further characteristics should be used only if they are appropriately weighted and certain minimum thresholds have been established. For example, we agree that both the number of active market makers and the range of potential buyers might be significant explanatory characteristics of liquidity across all asset classes. However, these variables will need to be measured and weighted differently depending on the asset class and the specific situation. For example, in a market with a small number of market makers any slight change may be significant, in contrast to a market with a large number of market makers where an increase/decrease of one or two market makers might not necessarily affect the liquidity of the market.

Further, we believe that the values for the various factors will need to be seen holistically and also re-evaluated over time. For example, in situations where the number of market makers is below a certain level, little turnover might be achievable in a crisis situation even where there is a large number of potential buyers. Further, we generally believe that the variable “number of buyers” is a fairly vague and hard-to-validate in any case.

**Q5: Do you agree with the methodology proposed? Do you have alternative approaches that might be used?**

We agree with the aims of the EBA’s methodology. However, we believe that the EBA and firms must be able to perform this analysis at a sufficiently granular level in order to reach the right conclusions and have a high level of confidence in their measurements.

EBA states that it will provide guidance for institutions on “the factors they need to take into account when determining which assets are appropriate.”<sup>9</sup> We believe that such guidance will be most beneficial if the EBA and market participants access make use not only of transparent methodologies but also of the underlying data as it will allow the firms to perform an in-depth analysis. Markit’s liquidity scores and metrics are transparent and we will make the underlying data available to our clients to the extent possible. As a matter of principle we will not only provide clients with liquidity scores for the range of financial instruments that we cover, but also with the relevant underlying variables. This approach is based on our experience that many clients have specific views on which liquidity-driving factors they want to use as inputs and the weightings that they believe are appropriate for these respective factors in order to compute a Liquidity Score. Also, such approach allows users to combine our contextual liquidity and transparency data with turnover data from their own trading activity and relevant data from other sources.

Finally, while the overall objective underlying the discussion in the DP is to broaden the scope of LCR eligible assets, we are concerned that EBA’s strong focus on transaction data could result in substantially narrowing down the subset of instruments that would be eligible for inclusion in the LCR. In our view, the proposed approach focuses too heavily on transaction data that is not only difficult to source but also hard to interpret. Merely basing the LCR treatment on ex post trading turnover data is misleading in our view and does not capture the actual purpose behind the metric. As such, we recommend that the EBA focus its efforts on identifying criteria that point to a strong structural two-way market for the particular product.

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Markit appreciates the opportunity to comment on the EBA’s Discussion Paper on *Defining Liquid Asset in the LCR under the draft CRR*. We would be happy to elaborate or further discuss any of the points addressed above. In the event you may have any questions, please do not hesitate to contact the undersigned or Marcus Schüler at [marcus.schueler@markit.com](mailto:marcus.schueler@markit.com).

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has also started to develop its thinking on a range of specific characteristics that would only apply for a sub-set of asset classes.”  
EBA Discussion Paper, page 16.

<sup>9</sup> EBA Discussion paper, page 19.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Kevin Gould', enclosed within a rectangular border.

Kevin Gould  
President  
Markit