EBA/CP/2013/39

22.10.2013

Consultation Paper

Draft regulatory technical standards

On derogations for currencies with constraints on the availability of liquid assets under Article 419(5) of Regulation (EU) 575/2013 (Capital Requirements Regulation – - CRR)

Consultation Paper on draft regulatory technical standards on derogations for eligible currencies under Article 419(5) of Regulation (EU) 575/2013 (Capital Requirements Regulation – CRR)

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1. Responding to this consultation

The European Banking Authority (EBA) invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed / rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 22 December 2013. Please note that comments submitted after this deadline, or submitted by other means, may not be processed.

Publication of responses

Please clearly indicate in the consultation form whether you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) No 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found in the Legal notice section of the EBA website.

2. Executive summary

The Capital Requirements Regulation [1] (CRR) sets out prudential requirements for liquidity which will be applicable as of 1 January 2014.

In a number of articles, the CRR contains specific mandates for the EBA to develop draft regulatory or implementing technical standards (RTS and ITS) relating to liquidity requirements. These standards will be part of the single rulebook enhancing regulatory harmonisation.

Main features of the RTS

This Consultation Paper proposes draft RTS related to Article 419(5) of the CRR, which requires the EBA to specify the derogations referred to in Article 419(2) including the conditions of their application. In accordance with Article 419(2), either or both of the derogations shall apply for currencies listed in the ITS of Article 419(4) with constraints on the availability of liquid assets. For these currencies, the justified needs for liquid assets in light of the liquidity coverage requirement in Article 412 exceed the availability of those liquid assets in a currency. The derogations are intended to address the inherent difficulties that institutions would face in meeting their liquidity coverage requirement in such currencies where it is not possible to reduce, by sound liquidity management, the resultant need for liquid assets and the holdings of those assets by other market participants.

If appropriate, institutions can choose to apply one or more of the two derogations pursuant to Article 419(2), of which the first (derogation A) allows the use of liquid assets denominated in a foreign currency, and the second (derogation B) allows the use of credit lines committed by the relevant central bank as liquid assets. In the draft RTS, these derogations, and the conditions for their application, have been specified with the following overarching objectives in mind. First, the application of a derogation should not be advantageous to the extent that, while it corrects for a disproportionate impact, it would lead to an uneven playing field between institutions. Second, the application of a derogation should not lead to undue risks for an institution. Third, the use of a derogation should be limited, and – in accordance with Article 419(3) – inversely proportional to the availability of the relevant assets.

For these reasons, the draft RTS restricts the use of any derogation by requiring institutions to, firstly and continuously, seek to reduce their need for a derogation. Such reduction measures should include better management of the inflow cap, prudent changes in liquidity management or renewed efforts to acquire liquid assets in the domestic currency. A derogation can be applied only in circumstances where an institution demonstrates that all of these steps have been taken and the justified need for the liquid assets remains.

Further measures to prevent unnecessary use of a derogation by institutions are embedded in the operation of the two derogations provided for in these RTS. In this regard, under derogation A, a general additional 8% haircut has to be applied to foreign currency liquid assets held to meet domestic

[1] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012

currency net outflows to adjust for currency risk. This additional haircut can be lower in case of a mutually supported currency peg and higher in case of a non-global currency. Under derogation B, the associated fees to be paid by institutions to the Central Bank should offset the higher yield earned on the assets kept to secure the credit lines and, if applicable, also incorporate a charge reflective of the amount drawn down.

More generally, the application of one or more of the derogations by an institution will require that mitigating action be taken to address potential risks arising from the use of derogations. Institutions should have the capacity through mechanisms or controls to limit or mitigate the risk of unintended consequences from the use of these derogations. An integral part of supervisory review means that institutions will have implemented mechanisms to monitor, disclose and assess the need for and use of these derogations.

The draft RTS also contain a limit to the total use of the derogations by institutions, which equals the relevant shortfall percentage in the annex of the ITS containing a list of currencies with constraints on liquid assets under Article 419(4) CRR. These percentages indicate the estimated aggregate shortfall compared to the aggregate demand generated by the liquidity coverage requirement for each currency on the list. The EBA's view is that the aggregate estimated shortfall in liquid assets can be offset by allowing each institution to cover its individual net outflows by means of the derogation up to the aforementioned percentage. In that way, the use of derogations is inversely proportional to the availability of assets of high or extremely high liquidity and credit quality such as is prescribed by Article 419(3).

The process by which institutions apply derogations is underpinned by a notification requirement to provide competent authorities with detailed information 30 days prior to the initial use of the derogation or of a material change to current usage. Additionally, the use of derogations A and B will be reported in the ITS in compliance with the liquidity coverage requirement reporting formats set out under Article 415(3) CRR.

Following the close of the consultation on 22 December 2013, the EBA will assess the responses received and consider whether or not any changes should be made to the draft RTS.

The EBA must submit the draft RTS to the Commission by 31 March 2014.

3. Background and rationale

The nature of RTS under EU law

The present draft RTS are produced in accordance with Article 10 of the EBA regulation ([2]). In accordance with Article 10(4) of the EBA regulation, RTS shall be adopted by means of a regulation or decision.

According to EU law, EU regulations are binding in their entirety and directly applicable in all Member States. This means that, on the date of their entry into force, they become part of the national law of the Member States and that their implementation into national law is not only unnecessary but also prohibited by EU law, except in so far as this is expressly required by them.

The RTS are in the form of a regulation to ensure harmonisation of the liquidity requirements and a level-playing field. This entails that the derogations applicable under Article 419(2) CRR are available in all the relevant Member States and are subject to the same conditions.

Background and regulatory approach followed in the draft RTS

In January 2013, the Basel Committee on Banking Supervision (BCBS) published a revised text of its rules on the liquidity coverage ratio (LCR) ([3]). The objective of the LCR is to promote the short-term resilience of the liquidity risk profile of banks. It does this by ensuring that banks have an adequate stock of unencumbered high-quality liquid assets (HQLA) that can be converted easily and immediately in private markets into cash to meet their liquidity needs for a 30-calendar-day liquidity stress scenario. It is intended that the LCR will improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source, thus reducing the risk of spillover from the financial sector to the real economy.

The BCBS identified that some jurisdictions may have an insufficient supply of HQLA in their domestic currency to meet the aggregate demand of banks with significant exposures in this currency. To address this situation, alternative treatments for holdings in the stock of HQLA may be applied to a limited number of currencies and jurisdictions. It is envisaged that eligibility for such alternative treatment will be based on meeting a set of qualifying criteria and will be determined through an independent peer review process overseen by the BCBS.

The CRR provisions related to liquidity coverage requirements translate these BCBS proposals into EU law. The draft RTS as put forward by the EBA for this consultation are a direct result of the CRR provisions.

In accordance with Article 419(1) CRR, the EBA will assess the availability for institutions of assets of extremely high liquidity and credit quality as defined in Article 416(1)(b) in the currencies that are

([2]) Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC.
([3]) http://www.bis.org/publ/bcbs238.htm.

relevant for institutions in the Union. Although that is not the specific purpose of this consultation, it should be noted that, in accordance with Article 419(4), the EBA will produce ITS listing the currencies with constraints on the availability of liquid assets, which will be submitted to the Commission by 31 March 2014. The ITS and RTS, adopted under Article 419(4) and 419(5) respectively, will have to be read in conjunction with each other.

The purpose of the RTS in this consultation paper is to provide details of the derogations referred to in Article 419(2), including the conditions of their application, where the justified needs for liquid assets emanating from the liquidity coverage requirement in Article 412 of the CRR exceed the availability of those liquid assets in a currency. In this situation, one or more derogations may be applied. The derogations provide that:

- the denomination by currency of the liquid assets may be inconsistent with the distribution by currency of liquidity net outflows by derogation to point (f) of Article 417;

- for currencies of a Member State or third countries, required liquid assets may be substituted by credit lines from the central bank of that country, which are contractually irrevocably committed for the next 30 days and are fairly priced, provided that the competent authorities of that Member State or third country do the same and that Member State or third country has comparable reporting requirements in place.

In the draft RTS, these derogations, and the conditions for their application, have been specified with the following overarching objectives in mind. First, the application of a derogation should not be advantageous to the extent that, while it corrects for a disproportionate impact, it would lead to an uneven playing field between institutions. Second, the application of a derogation should not lead to undue risks for an institution. Third, the use of a derogation should be limited and – in accordance with Article 419(3) – inversely proportional to the availability of the relevant assets.

For these reasons, the draft RTS restricts the use of any derogation by requiring institutions to reduce their need for it, such as by a better management of the inflow cap, changes in liquidity management or renewed efforts to acquire liquid assets in the domestic currency. Only if an institution demonstrates that all of these steps have been taken, and the insufficiency remains, can a derogation be applied.

Further measures to prevent unnecessary use by institutions are embedded in the operation of the two derogations provided for in these RTS. Under derogation A, a general additional 8% haircut has to be applied to foreign currency liquid assets held to meet domestic currency net outflows to adjust for currency risk. This additional haircut can be lower in case of a mutually supported currency peg and higher in case of a non-global currency. Under derogation B, the associated fees to be paid by institutions should offset the higher yield earned on the assets kept to secure the credit lines and, if applicable, also incorporate a charge reflective of the amount drawn down.

More generally, the application of one or more of the derogations by an institution will require that mitigating action be taken to address potential risks arising from the use of derogations. Institutions should have the capacity through mechanisms or controls to limit or mitigate the risk of unintended consequences from the use of these derogations. An integral part of supervisory review means that institutions will have implemented mechanisms to monitor, disclose and assess the need and use of these derogations.

The draft RTS also contain a limit to the total use of the derogations by institutions, which equals the relevant shortfall percentage in the annex of the ITS containing a list of currencies with constraints on liquid assets under Article 419(4) CRR. These percentages indicate the estimated aggregate shortfall compared to the aggregate demand generated by the liquidity coverage requirement for each currency on the list. The EBA's view is that the aggregate estimated shortfall in liquid assets can be offset by allowing each institution to cover its individual net outflows by means of the derogation up to the aforementioned percentage. In that way, the use of derogations is inversely proportional to the availability of assets of high or extremely high liquidity and credit quality such as is prescribed by Article 419(3).

The process by which institutions apply derogations is underpinned by a notification requirement, to provide competent authorities with detailed information 30 days prior to the initial use of the derogation or of a material change to current usage. Additionally, the use of derogations A and B will be reported in the ITS in compliance with the liquidity coverage requirement reporting formats set out under Article 415(3) CRR.

It should also be noted that the EBA will conduct further work in this area. In accordance with the Report to the Commission under Article 509 CRR to assess the implications of introducing liquidity coverage requirements in EU, the EBA will assess, under point (h) of paragraph 2 of that article, the derogations from requirements on the composition of the liquid assets that institutions will be required to hold, where in a given currency the institutions' collective justified needs for liquid assets exceed the availability of those liquid assets and conditions such derogations should be subject to. The first report is to be submitted to the Commission by 31 December 2013. On the basis of this report, the Commission's delegated act adopted to introduce liquidity coverage requirements under Article 460 CRR may lead to potential amendments in the workings of the derogations. More specifically, the delegated act could introduce a cap on the amount of assets of high liquidity and credit quality reported under Article 416(1)(d) that are recognised in the liquidity buffer. A further derogation relating to the additional use of these assets of high liquidity and credit quality with more stringent haircuts could, therefore, be introduced to address constraints on available assets of extremely high liquidity and credit quality that may arise from the application of the cap. This would be similar to what the BCBS standard terms 'Option 3', namely the additional use of Level 2 assets with more stringent haircuts.

Timing of RTS development and application date

The EBA intends to finalise the draft RTS and endorse it for submission to the Commission by 31 March 2014.

4. Draft regulatory technical standards on derogations for eligible currencies under Article 419(5) of the Capital Requirements Regulation

Between sections of the text of the draft RTS that follows, further explanations of specific aspects of the proposed text are occasionally provided, which either offer examples or provide the rationale behind a provision, or set out specific questions for the consultation process. Where this is the case, this explanatory text appears in a framed text box.

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COMMISSION DELEGATED REGULATION (EU) No …/..

of XXX

supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards to specify the derogations concerning currencies with constraints on the availability of liquid assets

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 575/2013 of 26 June 2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms[4], and in particular Article 419(5) thereof,

Whereas:

(1) The Basel Committee on Banking Supervision has established international standards regarding the liquidity coverage ratio and liquidity risk monitoring tools (the BCBS standards).

(2) To help ensure effective oversight and control of the use of the derogations in Article 419(2) of Regulation (EU) No 575/2013 and effective monitoring of institutions' compliance with the requirements applicable to use of the derogations, in accordance with the BCBS standards, institutions should notify competent authorities of their initial use of the derogations or a material change to their use of the derogations.

(3) The BCBS standards establish guiding principles for supervisors in jurisdictions with insufficient high quality liquid assets. In line with Principle 3 of the BCBS Standards, the assessment of justified needs should ensure that banks have, to the extent practicable, taken reasonable steps to use high quality liquid assets and reduced their overall level of liquidity risk to improve compliance with the liquidity coverage requirement, before the derogations are applied.

(4) In line with Principles 1 and 4 of the guiding principles for supervisors, the application of the derogations should ensure that institutions' use of the derogations is not simply an economic choice that maximises the profits of the institution through the selection of alternative high quality liquid assets based primarily on yield considerations and to establish a mechanism for restraining the usage of the derogations to mitigate risks of non-performance of the alternative assets. Appropriate haircuts should be established for the derogation in point (a) of Article 419(2) of Regulation (EU) No 575/2013 and to inform the fee structure for the derogation in point (b) of that Article taking into account the BCBS standards.

(5) In line with Principle 2 of the guiding principles for supervisors, the use of the derogations should be constrained for all institutions with exposures in the relevant currency. Pursuant to Article 419 CRR, such constraints should be inversely proportional to the availability of assets of extremely high or high liquidity and credit quality. For these reasons the use of the derogations should be limited to a percentage of an institution's net liquidity outflows in the relevant currency which corresponds to the relevant shortage in liquid assets in that currency.

(6) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) (EBA) to the Commission.

(7) The EBA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010.

HAS ADOPTED THIS REGULATION:

Article 1- Subject matter

This Regulation sets out regulatory technical standards to specify the derogations concerning currencies with constraints on the availability of liquid assets referred to in Article 419(2) of Regulation (EU) No 575/2013.

Explanatory text for consultation purposes

A detailed notification requirement has been included to ensure that the use of derogations can be monitored and supervised by the competent authorities. This is important especially since institutions themselves can decide on the application of the derogations, provided that the relevant currency is listed in the ITS referred to in Article 419(4) of CRR. There could be an incentive to excessively use the derogation in cases where there is an economic benefit. The notification requirement also takes effect in cases where there is a material change in the use of the derogation, such as an unexpected change in the intensity of the use. A 30 day notification period is seen as a minimum period for competent authorities to be informed on the initial use of derogations or a material change to usage. It is acknowledged that in exceptional circumstances it may not be possible to provide the notification of a material change to competent authorities within the 30 day period specified. In this instance, institutions should ensure that competent authorities are notified as soon as possible. The notification is to be updated thereafter annually and contain the necessary information to allow competent authorities assess and monitor usage. The introduction of this notification requirement closer aligns the draft RTS with the requirement of the BCBS guidelines 238 to set up a supervisory monitoring framework (paragraph 66).

Question 1: Do you agree with the proposed notification mechanism, its contents and timelines? If not, why not, and what should be altered?

Article 2 – Notification of the use of a derogation

(1) An institution shall notify the competent authority of its use of one or more of the derogations referred to in Article 419(2) of Regulation (EU) No 575/2013. The notification shall be provided in writing 30 days before the first use of the derogation and before any material change in the use of the derogation. In exceptional circumstances where it is not possible to provide competent authorities with the notification of a material change within 30 days, institutions shall provide the notification as soon as possible. The notification shall be updated at least annually.

(2) The notification shall include the following information:

(a) whether the institution is using, or intends to use, the derogation in point (a) of Article 419(2) of Regulation (EU) No 575/2013 (hereinafter "derogation A"), the derogation in point (b) of that Article (hereinafter "derogation B"), or both derogations;

(b) how the institution meets or intends to meet the conditions set out in Article 419(3) of Regulation (EU) No 575/2013 and the requirements of this Regulation;

(c) where the institution uses or intends to use derogation A, the details of the calculation of the haircuts specified in Article 4(5);

(d) where the institution uses or intends to use derogation B, the details of the credit line fee calculation specified in paragraphs 5 to 7 of Article 5;

(e) an estimate of the institution's future use of the derogation or derogations including a comparison of the institution's liquidity position if it uses the derogation or derogations with its liquidity position if it does not make such use;

Explanatory text for consultation purposes

The derogations are intended to offset the inherent difficulties that institutions would face in meeting the liquidity coverage requirements in currencies with constraints on the availability of liquid assets. Apart from this intention however, any use of a derogation is in itself undesirable, given that it may lead to an unlevel playing field with other institutions and to other inherent risks. For this reason the approach taken in the draft RTS is to discourage the use of any derogation by first requiring institutions to reduce their need for it, such as by a better management of the inflow cap, changes in liquidity management or renewed efforts to acquire liquid assets in the domestic currency. An example of the latter may involve a test to see whether the purchase of assets of high or extremely high liquidity and credit quality would significantly affect the market price of these assets. Only if an institution can demonstrate that all of these steps have been taken, a derogation can be applied. Such a setting of steps aligns these draft RTS closer to principle 3 of paragraph 67 the BCBS guidelines. Also it reflects Article 419(3) CRR, which requires insitutions to demonstrate that their holdings of liquid assets are consistent with the availability of those assets in the market prior to using one of the derogations.

Question 2: Are the steps to prevent the unnecessary use of a derogation clearly described? Do you see these steps as appropriate? If not, why not, and what should be altered? Are there any additional specifications that could clarify the assessments under paragraphs 1 and 2 of Article 3?

Article 3 – Assessment of justified needs

An institution does not have justified needs for liquid assets for the purpose of Article 419(3) of Regulation (EU) No 575/2013 unless it meets each of the following conditions:

(1) it has reduced, by sound liquidity management, the need for liquid assets in the full range of business conducted by the institution;

(2) its holdings of liquid assets are consistent with the availability of those assets in the currency.

Explanatory text for consultation purposes

Derogation A makes it possible for institutions that face justified constraints, to hold assets of high or extremely high liquidity and credit quality in a currency different from its liabilities and count them for purposes of liquidity coverage requirements. . The EBA acknowledges that derogation B can only be used if the relevant central bank arranges for its use. For as far as central banks don't, derogation A is the only derogation by default. The EBA foresees that the assets held for the purposes of Derogation A and the credit line granted for the use of Derogation B will be reported in the liquidity coverage reporting templates of liquidity coverage reporting under Article 415(3) CRR.

In line with the BCBS approach (principle 1 and 4 of paragraph 67 the BCBS standard) a general additional 8% haircut has to be applied to control for the heightened level of currency risk. In contrast to the BCBS approach however, this haircut has to be applied for all foreign currency denominated assets held under this derogation. As a reminder, the BCBS standard gives room for competent authorities to allow foreign currency denominated assets under this derogation to be exempt from the 8% haircut up to a certain threshold (this threshold cannot be set higher than 25% of total net cash outflows in the domestic currency). The EBA does not propose to include such threshold given that medium-sized and smaller currency mismatches also increase the risk of a reduced value of liquid assets after a 30-day stress scenario. Additionally, the BCBS mentions the 25% as the maximum that the relevant competent authorities can allow for if appropriate, implying that competent authorities can also set this value at 0%. In this Regulation, the EBA can not legally give discretionary power to competent authorities on this point and has to propose a single percentage.

For currencies where the liquid assets are denominated in a currency that is not actively traded in global foreign exchange markets, the currency risk can be significantly higher. Accordingly, in such case the haircut should be higher to reflect this risk. The largest monthly exchange rate movement between both currencies in a 10 year period seems to be appropriate. Note in this regard that it is prudent to take a long time period as foreign exchange stresses may not materialise in a given year. At the same time it may not be beneficial to look too far back as the fundamentals behind a currency's sensitivity may change.

For currencies subject to a mutually-supported peg, it seems appropriate to apply a lower haircut. For such cases the haircut should equal the width of the entire currency band. Note that it has not been decided to take the deviation from the middle of the band to the end of the band, as that would lead to an underestimation of risk in cases where at the time of reporting the currency operates at the higher end of the band. An important pre-condition for applying this is that the central banks of both currencies should be obliged to support the peg. For example currencies under the ERM II would qualify.

Question 3: Are the workings and conditions of derogation A clearly described? Do you see these steps as appropriate? If not, why not, and what should be altered?

Question 4: What criteria would you regard as useful for evaluating the historical evidence as mentioned in paragraph (4a) of Article 4?

Question 5: Is the additional 8% haircut on foreign denominated assets held under derogation A appropriate? If not, why not, and what alternative treatment would you propose?

Article 4 – Derogation A

(1) This Article specifies derogation A.

(2) An institution shall take all reasonable steps to fulfil the liquidity coverage requirement in Article 412 of Regulation (EU) No 575/2013 before applying derogation A.

(3) An institution shall ensure that it is at all times able to operationally identify liquid assets used to meet foreign currency liquidity coverage requirements and liquid assets held as a result of the application of derogation A.

(4) An institution shall ensure that its foreign exchange risk management framework meets each of the following requirements:

(a) currency mismatches resulting from the use of derogation A are adequately measured, monitored, controlled and justified;

(b) liquid assets which are inconsistent with the distribution by currency of liquidity outflows after the deduction of inflows can be liquidated in the currency of the Member State of the relevant competent authority whenever necessary including, in particular, in a stress scenario;

(c) historical evidence relating to stress periods supports the conclusion that the institution is able to promptly liquidate the assets referred to in point (b) .

(5) An institution which uses liquid assets in a currency other than the currency of the Member State of the relevant competent authority to cover liquidity needs in the latter currency shall apply an additional haircut of 8% to the value of those assets. Where the liquid assets are denominated in a currency that is not actively traded in global foreign exchange markets the haircut shall be the higher of 8% or the largest monthly exchange rate movement between both currencies in the ten years prior to the reporting date. Where the currency of the Member State of the relevant competent authority is formally pegged to another currency under a mechanism in which the central banks of both currencies are obliged to support the currency peg, the institution may apply a haircut equal to the width of the exchange rate band.

Explanatory text for consultation purposes

Derogation B allows the use of credit lines that are specifically committed by the central bank for the purposes of performing as liquid assets. This implies that the ability of an institution to make use of this derogation, amongst other factors, depends on whether the relevant central bank provides this specific facility. Additionally note that the credit line has to meet certain conditions to ensure the institution's ability to immediately and unconditionally draw down on the facility when needed during times of stress.

The collateral is to be fully posted at the central bank, the value of which after haircuts shall at all times equal or exceed the maximum amount that may be drawn on the credit line. This is to simulate the opportunity costs of actually holding a portfolio of qualifying liquid assets. For the same reason, the EBA considers it appropriate that a haircut of at least 15% would be applied to reflect the haircut applicable to assets referred to in Article 416(1)(d) of CRR (assets with high liquidity and credit quality), in accordance with Article 418 of CRR. If the haircut applicable to assets referred to in Article 416(1)(d) of CRR changes pursuant to the adoption of the delegated act referred to in Article 460 of CRR on liquidity coverage requirements, then the 15% minimum haircut may be revised accordingly. A lower haircut than the haircut applicable to assets referred to in Article 416(1)(d) of CRR would be deemed, by EBA, to be too far out of line with the liquidity and credit quality of the collateral that may be used under this derogation.

The fees to be paid by institutions should offset the higher yield earned on the assets kept to secure the credit lines. Otherwise there would be a direct economic benefit of applying the derogation for the institution involved. In this regard it is relevant to take into account the difference between the yield on the assets to secure the credit line and the yield on a representative portfolio of qualifying liquid assets. This yield difference would have to be paid over the entire amount of collateral used to secure the credit line, in order to simulate the opportunity costs of actually holding a portfolio of qualifying liquid assets. Such a setting of fees aligns these draft RTS closer to principles 1 and 4 of paragraph 67 the BCBS guidelines.

Question 6: Are the workings and conditions of derogation B clearly described? Do you see these steps as appropriate? If not, why not, and what should be altered?

Article 5 – Derogation B

(1) This Article specifies derogation B.

(2) An institution shall take all reasonable steps to fulfil the liquidity coverage requirement in Article 412 of Regulation (EU) No 575/2013 before applying derogation B.

(3) An institution shall obtain a credit line of the central bank which meets each of the following conditions:

(a) the institution has a legally binding entitlement to access the credit facilities which is supported by a documented agreement;

(b) following the decision to provide a credit line, access to the credit facilities is not subject to a credit decision by the central bank;

(c) the credit facilities can be drawn on by the institution without delay and no later than one day after giving notice to the central bank;

(d) the credit line shall at all times be available for a period which exceeds the 30 day period of the liquidity coverage requirement specified in Article 412 of Regulation (EU) No 575/2013.

(4) Institutions shall fully post collateral at the central bank. The value of the collateral after haircuts shall at all times equal or exceed the maximum amount that may be drawn on the credit line. This haircut shall at least equal 15%.

(5) An institution shall pay a fee for the credit line according to a fee structure that is designed not to provide an economic advantage or an economic disadvantage, compared to the position of institutions which do not make use of derogation B.

(6) The fee paid by an institution for the credit shall comprise the following fees:

(a) a fee which is based on the amount of the credit line drawn down;

(b) a fee which approximates the difference between the following amounts:

(i) the yield on the assets used to secure the credit line;

(ii) the yield on a representative portfolio of assets of the type set out in points (a) to (d) of Article 416(1) of Regulation (EU) No 575/2013.

(7) The fee referred to in paragraph 6(b) may be adjusted to take into account any material differences in credit risk between the sets of assets referred to in that paragraph.

Explanatory text for consultation purposes

The draft RTS also contain stipulations to keep the total use of the derogations by institutions limited.In this regard it contains a limit to the total use of the derogations by institutions, which equals the relevant shortage percentage in the annex of the draft ITS containing a list of currencies with constraints on the availability of liquid assets under Art 419(4) CRR. These percentages indicate the estimated aggregate shortage compared to the aggregate demand generated by the liquidity coverage requirement for each currency on the list. In the view of the EBA, the aggregate estimated shortage in liquid assets can be offset by allowing each institution to cover its individual net outflows by means of the derogation up to the aforementioned percentage. Therewith the use of derogations is inversely proportional to the availability of assets of extremely high or high liquidity and credit quality such as is prescribed by Article 419(3). The setting of such limits is deemed to align these draft RTS closer to principle 2 of paragraph 67 the BCBS guidelines.

Question 7: Is the proposal to limit the total use of the derogations by an institution to the relevant shortage percentage in the annex of the draft ITS containing a list of currencies with constraints on the availability of liquid assets under Art 419(4) CRR clearly described? If not, why not, and what further matters should be included? Do you see these stipulations as appropriate? If not, why not, and what should be altered?

Article 6 – Maximum level of usage of derogations

(1) An institution's use of the derogations in Article 419 of Regulation (EU) No 575/2013 shall not exceed the relevant percentage specified in respect of a currency in implementing technical standards adopted pursuant to Article 419(4) of Regulation (EU) No 575/2013.

(2) For the purpose of paragraph 1, the use of the derogations shall be calculated as the percentage that X represents of Y where:

(a) "X" is the sum of the value of all liquid assets under derogation A, after application of the haircuts of Article 418 CRR and Article 4(5), and the maximum amount that may be drawn on a credit line to which derogation B applies;

(b) "Y" is the institution's liquidity coverage requirement pursuant to Article 412 of Regulation (EU) No 575/2013.

Article 7 – Final provisions

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission
The President

[For the Commission
On behalf of the President

[Position]

5. Accompanying documents

5.1 Draft cost–benefit analysis/impact assessment

5.1.1 Introduction

1. This note outlines the assessment of the impact of the draft RTS regarding the specification of the derogations for currencies with constraints on the availability of liquid assets. The development of the draft RTS stems from the requirement presented in Article 419(5) (CRR).

2. Article 10(1) of the EBA regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council) provides that when any draft regulatory technical standards developed by the EBA are submitted to the EU Commission for adoption, they shall be accompanied by an analysis of 'the potential related costs and benefits'. This analysis should provide the reader with an overview of the findings regarding the problem to be dealt with, the solutions proposed and the potential impact of these options.

3. This note outlines the main expected impacts of the proposed provisions and provides a summary of the nature and expected magnitude of costs and benefits that may arise from the application of the principles proposed in the guideline.

5.1.2 Problem definition

Issues addressed by the European Commission (EC) regarding liquidity management

4. In its impact assessment of the CRD IV framework, the European Commission noted that the existing liquidity risk management approaches and supervisory regimes inadequately captured risks inherent in the underlying market practices and trends. These shortcomings contributed to the failure of several institutions and strongly undermined the financial health of many others, threatening financial stability and leading to unprecedented levels of central bank liquidity and government support.

5. To address this issue, the CRR proposes two minimum standards for funding liquidity. One of these requirements is the liquidity coverage requirement, which aims to ensure that an institution has enough high-quality liquid resources to survive an acute stress scenario lasting for 30 days. This requirement will contribute to realising the general objectives of CRD IV, as well as the two following specific objectives:

   - S.1 Enhancing adequacy of capital and liquidity requirements
   - S.2 Enhancing bank risk management

6. To meet the requirements of the liquidity coverage requirement, institutions must hold a stock of HQLA to cover the total net cash outflows over a 30-day period. Such assets should be liquid in markets during a time of stress and, in most cases, be eligible for use in central bank operations. Because in some jurisdictions there may be not enough HQLA available, the CRR leaves a possibility for institutions to use derogations to meet the requirements of the liquidity coverage requirement along the lines of what has been suggested in the Basel III framework.

Issues addressed by the technical standard and objectives

7. The CRR mandates the EBA to develop draft technical standards specifying the derogations referred to in Article 419(2), including the conditions of their application. With this RTS, the EBA will clarify under which conditions institutions can exercise these derogations and avoid the use of substantially divergent practices that could create an uneven playing and uncertainty regarding the condition of application of the liquidity coverage requirement across Europe.

8. The RTS will contribute to realising the objectives of the directive of improving liquidity risk management and ensuring that the resilience of all institutions to short-term liquidity shocks is tested against the same benchmark across the single market.

5.1.3 Technical options considered

Notification

9. Institutions operating with a currency listed as constrained on the availability of liquid assets can decide themselves whether or not they will use the derogations applicable. The EBA proposes that they should also notify their national supervisory authority about their choice, to allow the authority to a have a better view of the liquidity position of the firms and to improve supervision of the liquidity risks.

Scope of application of the haircut under derogation A

10. In line with the approach advocated by the BCBS, an additional 8% haircut has to be applied to the foreign-currency-denominated assets held under this derogation, to control for the heightened level of currency risk. However, contrary to the BCBS, the EBA does not allow an exemption from this haircut. The BCBS, in this respect, allows competent authorities to set an exemption between 0% and 25% of these foreign assets. The EBA expects that most of the institutions operating in currencies for which the availability of liquid assets is limited will rarely need to hold more than 25% of foreign assets to meet their liquidity requirement. Therefore, allowing this exemption would have given an unduly advantage to institutions able to use this derogation as well as leading to an underestimation of the potential currency risk.

11. To appropriately reflect differences in exchange rate volatilities in currencies, the additional haircut can be lower than 8% in case of a mutually supported currency peg and higher in case of a non-global currency. In the first category (mutually supported currency peg), the entire currency band will be taken as a haircut, and in the second category (a non-actively traded currency in global markets) the haircut is set to equal the largest monthly exchange rate movement between the relevant currencies in a 10-year period.

Haircuts and fee structure under derogation B

12. In line with the approach advocated by the BCBS, under derogation B the opportunity costs of actually holding a portfolio of qualifying liquid assets is simulated. For this reason, the EBA considers it appropriate that a central bank would set a haircut of at least 15%, which reflects the haircut applicable to assets referred to in Article 416(1)(d) CRR (assets with high liquidity and credit quality), in accordance with Article 418 CRR. For the same reason, the fees to be paid by institutions should offset the higher yield earned on the assets kept to secure the credit

lines. Otherwise the institution involved would enjoy a direct economic benefit from applying the derogation.

Maximum level of derogation

13. The draft RTS also contain a limit to the total use of the derogations by institutions, which equals the relevant shortfall percentage in the annex of the draft ITS containing a list of currencies with constraints on liquid assets under Article 419(4) CRR. These percentages indicate the estimated aggregate shortfall compared with the aggregate demand generated by the liquidity coverage requirement for each currency on the list. In the view of the EBA, allowing each institution to cover its individual net outflows by means of the derogation up to the aforementioned percentage, the aggregate estimated shortfall in liquid assets can be offset. In this way, the use of derogations is inversely proportional to the availability of assets of high or extremely high liquidity and credit quality, such as is prescribed by Article 419(3). The setting of limits explained above aligns these draft RTS closer to principle 2 of paragraph 67 of the BCBS guidelines.

5.1.4 Impact

Costs

14. This RTS defines only the conditions in which institutions can apply the derogation allowed in the CRR. The requirements made in this RTS are unlikely to raise material costs for the institutions that will use these derogations or for their national supervisory authorities.

15. The EBA has currently identified only a small number of currencies for which the availability of liquid assets is limited. The number of institutions operating in these currencies is also small and the amount of total assets that they hold represents only a small share of the total assets held by the banking sector in the EEA. The risk of creating an uneven playing field for the application of the liquidity coverage requirement is, therefore, small.

Benefits

16. By specifying how the derogations to the liquidity coverage requirement can be applied, the RTS will ensure that the institutions exercising them have similar practices. The requirements proposed will ensure that they are inversely proportionate to the shortfall of liquid assets, and can be used when they are appropriate, without giving undue disadvantages to the institutions that are not allowed to use them. Finally, the requirement in term of notifications will also contribute to help national supervisory authorities to be informed of the liquidity management practices of the institutions they monitor without creating an excessive burden on institutions.

Question 8: Do you agree with the above analysis of the cost and benefit impact of the proposals?

Question 9: Please provide any evidence or data that would further inform the analysis of the likely cost and benefit impacts of the proposals.

5.2 Overview of questions for Consultation

Question 1: Do you agree with the proposed notification mechanism, its contents and timelines? If not, why not, and what should be altered?

Question 2: Are the steps to prevent the unnecessary use of a derogation clearly described? Do you see these steps as appropriate? If not, why not, and what should be altered? Are there any additional specifications that could clarify the assessments under paragraphs 1 and 2 of Article 3?

Question 3: Are the workings and conditions of derogation A clearly described? Do you see these steps as appropriate? If not, why not, and what should be altered?

Question 4: What criteria would you regard as useful for evaluating the historical evidence as mentioned in paragraph (4a) of Article 4?

Question 5: Is the additional 8% haircut on foreign-currency-denominated assets held under derogation A appropriate? If not, why not, and what alternative treatment would you propose?

Question 6: Are the workings and conditions of derogation B clearly described? Do you see these steps as appropriate? If not, why not, and what should be altered?

Question 7: Is the proposal to limit the total use of the derogations by an institution to the relevant shortage percentage in the annex of the draft ITS containing a list of currencies with constraints on the availability of liquid assets under Article 419(4) CRR clearly described? If not, why not, and what further matters should be included? Do you see these stipulations as appropriate? If not, why not, and what should be altered?

Question 8: Do you agree with the above analysis of the cost and benefit impact of the proposals?

Question 9: Please provide any evidence or data that would further inform the analysis of the likely cost and benefit impacts of the proposals.