Consultation response

EBA Consultation Paper on draft Regulatory Technical Standards ('RTS') on the specification of Additional Objective Criteria referred to in Articles 29(2) and 34(2) of the LCR Delegated Act

13 January 2016

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to contribute to the EBA's consultation on its draft RTS relating to requirements for cross-border intra-group support under stressed conditions.

AFME and its members welcome the important work that the EBA is undertaking in this area to facilitate the consideration of the extent of the real liquidity risk across a banking group and to ensure that the movement of liquidity across members of a group to where it is needed is not unnecessarily constrained.

While we appreciate therefore the aims of the additional criteria that are set out in the consultation paper for the application of preferential treatment in the calculation of the LCR for cross-border intragroup liquidity flows, there appear, however, a number of practical considerations that should be revisited as follows:

Low Liquidity Risk Profile

We agree that the liquidity provider should present a low liquidity risk profile in order to apply the preferential treatment in the LCR calculation. We would suggest that the EBA reconsiders the requirement for the liquidity receiver to have a low liquidity risk profile. For banks operating a centralised liquidity model in particular, liquidity receivers often need intragroup liquidity support since they are generally unable to access sufficient market liquidity on a stand-alone basis or can only do so on a prohibitive basis. In order to improve the criterion from a functional perspective, we have some clarifying questions and suggestions:

We understand that the requirement under Article 2a of the draft RTS 'The liquidity provider and receiver shall comply with the required level of the liquidity coverage ratio ... on an on-going basis and for at least the previous 12 months', allows the receiver to take into account the liquidity support from the providing entity for the purpose of meeting its LCR requirement.

Additionally, with respect to Article 2a, we would recommend that the EBA considers removing the requirement to apply the preferential treatment following the supervisory review and evaluation process (SREP), since this process consists of a number of qualitative factors related to the supervisory judgement on the quality of Internal Liquidity Adequacy Assessment Process (ILAAP) documents, governance arrangements, data infrastructure and adequacy of internal controls. The calculation of the LCR requirement related to setting intragroup flows should remain a quantitative exercise with data driven methodology. We would note also that in many instances the SREP is undertaken at consolidated or sub-consolidated levels and that results might not be available on a single entity basis.

As a practical alternative measure, the EBA should separate the requirements around calculation of the LCR from the SREP process in Article 2a, given the time it will take for the European Central Bank (ECB) and other national competent authorities to conduct liquidity reviews. Given the duration of SREP processes and the workload for regulatory authorities, there is a possibility that it will be a prolonged time before an assessment of both liquidity provider and receiver are completed. In the interim, as the regulation is currently drafted, firms will be unable to apply the preferential treatment, which would lead to trapped liquidity within groups. This is contrary to the regulatory intention of the EBA when drafting these standards to ensure the appropriate use of intragroup liquidity lines. As an interim measure, we would suggest that the EBA allows firms to apply the preferential treatment utilising prior national competent authorities' views on the regulatory liquidity score for individual entities. Lastly, according to the final SREP Guidelines[1], regulators shall not be required to disclose the individual SREP component scores. Therefore, firms might not even have official confirmation of their liquidity risk score, which could create confusion within firms as to whether or not they are permitted to apply the preferential treatment.

ECB Consideration of Options and Discretions available in Union Law

For the most part the ECB's approach to intra-group liquidity outflows and inflows is consistent with the approach set out by the EBA. We note though that the ECB has suggested that the outcome of the SREP assessment should be considered only where past LCR reports are not available or where no quantitative requirements are in place. This would appear a more suitable approach than the EBA's automatic reference to Pillar 2 requirements for which it would be difficult to maintain a consistency of application and comparability across banks in relation to the requirement for the liquidity provider and receiver to have a 'low' liquidity risk profile according to the qualitative assessment.

External Written Legal Opinions

We understand the underlying rationale for the EBA's suggestion that institutions should obtain regular external written legal opinion to confirm that the legal, binding, and enforceable aspects of the credit or liquidity line agreement or commitment are valid and enforceable in all relevant jurisdictions. In practice, however, this is likely to prove highly burdensome and operationally difficult, not least owing to different legal frameworks across different jurisdictions. Instead, internal firm reviews based around the provision of letters of comfort might in the first instance and in most cases be a more proportionate starting point.

Given the number of legal entities within large cross-border financial services groups, requiring each and every liquidity line to be regularly reviewed and supported by an external legal opinion will be a cost intensive and time consuming process, which is not in line with the proportionality objective of European regulatory reforms. The EBA should consider amending the requirement to accommodate the principle of proportionality for example, firms should identify their most significant intragroup liquidity lines and these agreements should be

[1] EBA/GL/2014/13

externally reviewed. For less material liquidity lines, as mentioned, firms should be allowed to utilise their internal legal expertise to ensure that the agreements are legally binding.

Secondly, we would welcome further clarification related to Article 3a; "They shall repeat this review on a regular basis and shall draw on an external written and reasoned legal opinion." As part of the regular reviews, is it the intention of the EBA that a new legal opinion be secured every time each intragroup liquidity facility is reviewed? Other regulatory regimes have not required intragroup lines to be subjected to regular external legal review and it is questionable what value this process will add.

Thirdly, we would seek further clarification related to Article 3C; "The amount of the facility shall not be revised without the prior consent of the relevant competent authority" Amending the amount of intragroup liquidity facilities is a practical aspect of day to day liquidity risk management, therefore it seems unreasonable and overly intrusive to require regulatory approval each time an intragroup facility is amended. This would be especially burdensome during a stress event where speed of action is paramount. Intragroup liquidity lines and their potential use in stress forms part of the firm's recovery planning, which is the sole responsibility of the firm. Regulatory approval for these will delay the effectiveness of invoking mitigating contingency actions (which could include increasing committed intragroup liquidity facilities). This delay can potentially exacerbate a liquidity stress. We would strongly suggest that the text should be amended to require firms to notify the relevant competent authority of a material change in the amount of any facility on an annual basis as part of the ILAAP submission process or in the event of a proposed reduction.

Treatment of Third Country Entities

While the application of preferential inflow and outflow factors under the consultation appears limited to intra-group arrangements within Europe, clarification and background on the approaches that are likely to be taken in relation to third country entities is needed. For instance, the treatment of intra-group flows to entities in Member States from Parent companies based outside the EU, for example in the US, should be explained.

About AFME

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

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