EACB Views
On European Commission Delegated Act implementing the Liquidity Coverage Ratio (LCR) under Art. 460(2) CRR

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The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 3.700 locally operating banks and 71.000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 215 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 56 million members and 850.000 employees and have a total average market share of about 20%.
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Introduction

In an attempt to make the financial sector more resilient with regard to crises in general, the CRR's newly introduced minimum liquidity standards seek to ensure banks' liquidity at any given point in time. The corresponding liquidity standards that were adopted are based on the lessons learnt during the financial market crisis. Whilst the standards initially developed by the BCBS were primarily geared towards liquidity rules for internationally active banks, the liquidity rules developed as part of the CRR shall be applicable to all banks.

The cooperative banks' networks accounts for a material share in the credit supply to the households and SMEs. Particularly during the financial market crisis it became clear that, even during times of crisis, cooperative banks are capable of ensuring a sufficient degree of credit supply for the real economy. The key reason for this lies in the functioning liquidity balancing scheme within the cooperative financial network which ensures that the liquidity surpluses are pooled at the central institutions thus allowing an optimum liquidity management within the network. Local cooperative banks are the exclusive or majority shareholders of these central institutions. As a result, the cooperative local banks do not behave like external investors. In addition, within the cooperative banks' networks the mutual solidarity systems (e.g. IPS, guarantee systems etc.) neutralises to a great extent the effects of idiosyncratic liquidity shocks for local banks, resulting in a positive impact on financial stability.

Thus, for the purpose of balanced liquidity regulation, a number of issues deserve dedicated attention. In particular, the Members of EACB would like to draw the attention to a number of issues which are illustrated in this document. In the following chapter the key concerns are highlighted.

Summary of key issues

For the European cooperative banks, the key issues for the definition of a balanced LCR are the following ones.

1. *Cooperative banking networks liquidity systems (Chapter. 1)*
The specificities of cooperative liquidity networks have to be reflected in the delegated legal act. It is important that the LCR does not lead to liquidity disruptions in such systems. The cooperative liquidity systems proved their soundness throughout the crisis, so that, even the Basel Committee has addressed them. In these systems, local banks deposit their excess liquidity at their central institution, which then ensures the liquidity within the network. It is essential that also the delegated act properly reflects the particularities of these systems. Under certain conditions minimum internal deposits of local banks held at the central institutions of cooperative networks, or securities issued by central institutions, should be treated as HQLA for local banks. Moreover, the provision of Art. 422(3) CRR, according to which certain deposits under specific conditions should be considered as stable funding with a 25% outflow rate for central institutions, should be mantained. Likewise, we suggest that these monies have a symmetrical inflow rate as specified under Art. 425(2)(e). We also suggest to maintain the provision of Art. 425(1), according to which deposits placed by institutions within groups and institutional protection schemes are exempted from the caps on inflows. Also other deposits could be constituted at the central institution. Such deposits should be accounted as HQLA and enjoy a symmetrical treatment. Finally, deposits to fulfil Central Bank reserve' requirements of local banks held at networks' central institutions should generally qualify as HQLA, at the discretion of National Central Banks. Likewise, the methods and channels by which local cooperative banks access the Central Bank refinancing operations should be taken into account.

2. *Committed liquidity facilities (Par. 2.1)*
The CLFs should not be limited to Level 2B assets as their quality and liquidity is the same of a central bank deposit. The Basel Committee recognised in January the possibility for Restricted CLFs to be recognised in the liquidity buffer. However, we believe that the restrictions imposed are extremely hampering for an actual use of the facility. The pricing should not be set once and for all with no connection with market conditions and monetary policy. It should be left instead to the discretion of Central Banks.

3. *Covered bonds as Level 1 assets (Par. 2.2)*
Covered bonds should be recognized as Level 1 assets without strict conditions. Covered bonds are, in fact, a highly transparent and regulated asset class. The EBA empiric exercise of the report on HQLA definition issued last December, demonstrated the extremely high liquidity of covered bonds. EBA, however, imposed unreasonably severe restrictions for the use of this asset class among

Level 1 assets. Also Recital 100 CRR stresses the importance of the use of covered bonds in the liquidity buffer as extremely HQLA, to promote diversification and a high quality liquidity profile.

4. *Treatment of retail deposits (Par. 3.1)*
   Cooperative banks believe that retail deposits should benefit from the 3 % run-off rate proposed by the Basel Committee in January 2013. The collection of retail deposits represents an element of the utmost importance for the cooperatives funding, due to the proximity to the real economy of cooperative banks.

Moreover we would like to draw attention on the following issues:

5. *Bonds from regional governments and local authorities (Par. 2.3)*
   The bonds of regional governments and local authorities should be treated as exposures to central governments and as such should be added to Level 1 assets. In addition, bonds of promotional banks which are guaranteed by regional and local governments should be eligible for Level 1 assets.

6. *Cap on Level 2 assets (Chap. 3)*
   We have doubts about the introduction of fixed caps for Level 2 and Level 2b assets due to their unintended impacts on the financing opportunities of the real economy, when banks would be driven to invest strongly in level 1 assets. Recital 100 CRR recommends institutions to hold a diversified buffer of liquid assets.
   a. From our point of view, the new regulatory rules concerning liquidity should evaluate if a bank has enough liquidity even in times of stress (LCR). A bank is always able to transfer a bond, which is accepted as collateral in the repo Pool of a regulated central counterparty like the Eurex or the LCH, into cash whenever needed. Thus securities marketable on such platforms should be treated as liquid assets in the LCR (with haircuts), instead of being excluded from the liquidity buffer in total.
   b. Therefore, we propose to introduce a graduate system of haircuts for repo-eligible assets (on regulated markets) instead of fixed percental caps.

7. *Internal flows and derogations from the inflow cap (Par. 4.2, 4.3)*
   It is important that all internal flows within a group are granted a symmetrical treatment.
   Moreover, derogations from the inflow cap should be allowed for some business models, e.g. pass-through financing.

1. The management of cooperative liquidity systems and of National Central Banks reserves' requirements

Cooperative banking networks are characterised by a peculiar division of labour. Typically local cooperative banks serve their members of their area by collecting deposits and providing credit. On the other hand, the central institutions, controlled by local by these local banks, act as a service provider for the network and perform a full variety of tasks. In particular, they are in charge of ensuring the liquidity of the network and allocate it where needed. Moreover, they perform operations with the national central bank or support local banks in such operations as the latter often have no direct access.

In particular the following mechanisms need to be distinguished when specifying the mechanics of LCR.

1) The first mechanism is the way liquidity is managed within cooperative banking networks, and especially the use of internal deposits placed at the sectoral central institutions of the networks. (*Cooperative liquidity systems*)
2) The second mechanism is when local cooperative banks comply with the minimum reserves' requirement of their National Central Banks via the central institutions of their network, in agreement with Regulation 1745/2003 of ECB. (*Minimum reserves and other National Central Bank operations*)

1.1 Cooperative liquidity systems

As mentioned earlier, cooperative liquidity systems typically imply that local cooperative banks deposit their excess liquidity at their network's central institutions, which may pass the monies either to other banks on the network, keep it for its own operations or place it on the capital market. This cooperation is often based on contracts of law, but often there are many more ties, such as ownership of the central institution, a common brand name and advertising, etc.

The Basel Committee has also dedicated specific attention to the liquidity system of cooperative banks' networks[1]. In fact, due to the stable deposit base of local banks (see Annex) cooperative liquidity systems have proven highly stable throughout the financial crisis so that liquidity has never been an issue, even during the liquidity crunch in 2008.

While having proven particularly sound and having provided stability for their economies even in turbulent times, many cooperative banking networks would not qualify for the application of the waiver envisaged under Art. 8 CRR, for a consolidated approach of the LCR. The criteria of article 8 CRR are designed for centralised groups, but do not reflect the spirit of decentralised cooperative networks. Therefore,we believe that there should be sufficient flexibility in the application of Art. 8 CRR.

[1] BCBS: Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools, January 2013, para 105-106.

The delegated act on the LCR must not weaken the cooperative networks and liquidity systems, which have definitely produced evidence of their functioning and their added-value. Quite to the contrary, we strongly believe that it should support those systems and even create incentives for maintaining or even further developing them. These systems are highly important for the stability of real economy financing.

Beyond some key features already reflected in the regulation, a number of issues are of utmost importance for the delegated act to properly reflect the particularities of these systems. Otherwise the act could lead to disrupting existing liquidity refinancing frameworks inside cooperative groups.

1.1.1 **Internal deposits recognized as LCR liquid assets**

As referred above, there are numerous strong ties within cooperative banking networks. Peculiar features are, in fact, the affiliation to the network, common branding, the ownership of the central institution by the local banks of the network, the existence of mutual solidarity and cross-guarantee schemes, a central institution ensuring an efficient and coordinated liquidity management within the Group.

As mentioned earlier, local/regional banks of cooperative banking networks place their excess liquidity at the central institution of the their network, which then uses it for ensuring the liquidity of the network (internal deposits). Often, but not always, there are legal or statutory arrangements for the placing of such deposits.

We believe that article 416(1)(f) has to be maintained in the delegated act and that local/regional banks should be given the right to constitute their HQLA buffer through deposits placed at the central institution of the network. Article 416(1)(f) CRR gives the possibility to recognise some internal deposits as liquid assets, provided that certain circumstances are met. We strongly support that this possibility is indeed given to local banks within cooperative networks.

According to article 416(1)(f) those deposits should be statutory or legal *minimum* deposits inside cooperative networks. This would confirm existing practices and create a positive incentive structure for liquidity systems. In other cases the obligation is not quantified. The Commission's delegated act should define only broad conditions for such a recognition as highly liquid (such as the use of a specific account, separation from other internal current accounts, ITC). Instead, competent authorities should have the discretion to recognise the characteristics of established liquidity networks on a number of elements.

1.1.2 **Extending the scope of Art. 416(2)(a) corresponding to Art. 416(1)(f): bearer bonds as HQLA**

In some cases, central institutions issue uncovered bearer bonds to manage the liquidity of the network. We advocate that such bonds should be included in the HQLA if the issuer (the central institution) and the bearer (a local cooperative bank) are members of the same network. Elements to deem such bonds eligible for the HQLA stock could be: a proof of sufficient liquidity in the network (consolidated LCR > 100%) and a liquid secondary market for these securities. This approach based on an institutional protection scheme is similar to the treatment of cooperative financial network shareholdings under the capital adequacy requirements pursuant to Article 49(3) CRR.

More specifically, we request a corresponding interpretation of Art. 416(2) (a) CRR / an amendment to this Article to include one further sub-item (iv) which – subject to the aforementioned preconditions - allows treating bearer bonds issued by central institutions under the provisions of Art. 416(1)(d).

Under the provisions of Art. 418(1), a corresponding haircut of 15 % is requested for assets within the meaning of Art. 416(1)(d). This was confirmed by the EBA in its report on HQLA definition and on operational requirements for liquid assets and could become equally applicable to bearer bonds issued by the cooperative banks central institutions.

Such approach would take into account the idiosyncrasies of the cooperative financial networks' protection schemes. In our view, it would be economically reasonable to include bearer bonds issued by cooperative central institutions under the regulatory scope.

An adequate liquidity situation at the network level could be demonstrated on an ongoing basis by the aggregate/consolidated network LCR calculation, in analogy to the solution already adopted and implemented in the field of own funds (Art. 49(3) CRR). This approach would allow to eliminate intra-network positions (including but not limited to bearer bonds, provided there is recognition as HQLA).

In this context, it is of paramount importance that the central institution's liquidity will not be impaired when the bearer bonds issued by the central institutions are sold by the local banks on the secondary market. Due to their very nature, bearer bonds feature an intrinsically high degree of liquidity. Hence, not only "minimum deposits" and internal deposits but also bearer bonds issued by the cooperative central institutions should consequently be recognised as part of the network liquidity as "covered" securities (Level 2 Assets), due to the strong institutional protection scheme.

1.1.3 <u>Minimum statutory internal deposits as stable funding</u>

Internal deposits can also play an important role as stable funding for the central institution. Under the conditions of Art. 422(3) CRR, such deposits can be considered as stable funding for the central institutions and benefit of a 25% outflow rate. The symmetry, recognised in Art. 425(2)(e) CRR, presumes a 25% inflow rate at the level of the local banks. These provisions should be maintained or reflected in the delegated act.

1.2 Minimum reserves at the cooperative sectorial central institutions and other operations with National Central Banks

As indicated earlier, the central institutions of cooperative networks are not only managing the liquidity system of the network. In many countries they are also a platform for the access of local/regional banks to the national central bank and for supporting central bank transactions of those regional local banks.

1.2.1 Recognition of the liquidity of required reserves at the National Central Bank

Local banks often constitute their minimum reserves at the Central Bank through deposits placed at the central institution in accordance with the Regulation (EC) 1745/2003 of the ECB on minimum reserves. According to Art. 10 of the regulation, in fact, an institution can be allowed "to hold all its minimum reserves indirectly through an intermediary resident in the same Member State. The cooperative central institution acts as an and normally effects part of the administration (e.g. treasury management) for the institution for which it is acting as intermediary, beyond the holding of minimum reserves. For solvency purposes exposures to an institution in the form of minimum reserves required by the National Central Bank are considered as exposures to the central bank itself (Art. 119(4) CRR). Thus, also under the LCR a specific treatment for these exposures is justified.

When the central institution is responsible to fulfil the minimum reserve requirement on behalf of the entire network, as envisaged under Art. 11 of the Regulation (EC) 1745/2003, and the correspondent part of the deposits with the central bank are liquid assets of the central institutions, such exposures should therefore be treated as liquid assets of the local cooperative banks.

According to Art. 416(1)(a) cash and exposures to Central Banks , provided that they can be withdrawn at any time in times of stress, are to be considered liquid assets. Moreover, according to Art. 416(1)(a), it is left to Central Banks to assess to which extent the minimum reserves can be withdrawn in times of stress and thus be considered as liquid assets, or whether they should be neutralised for LCR purposes.

It is important that this issue remains under the control of Central Banks and that the delegated act on the LCR reflects Art. 416(1)(a) CRR.

Both the potential interaction with monetary policy (changing the level of minimum reserves will mechanically change the LCR of the system if minimum reserves cannot be considered as liquid assets), and the level playing field issues (all Central Banks do not have the same level of minimum reserve requirement) must be taken into account.

Moreover, these internal deposits should be treated in a symmetrical way with the required reserves at the Central Bank placed by the central institution at the Central Bank.

1.2.2 Use of an internal liquidity facility granted by the Central institution

In many cases, the central institution grants liquidity facilities to local/regional banks inside the cooperative network. Such facilities should be accepted as a liquid asset for the local institutions, when a corresponding CLF is granted to the central institution by the Central Bank. We believe that this would only reflect a possibility given to cooperative networks under article 416 1 f of CRR, but more clarification would be welcome.

1.2.3 Other operations with National Central bank

Pre-positioned or pledged assets standing available in a collateral pool

Paragraph 31 of Basel III liquidity rules lays down that "assets which qualify for the stock of HQLA that have been pre-positioned or deposited with, or pledged to, the central bank or a public sector entity (PSE) but have not been used to generate liquidity may be included in the stock".

A similar treatment is recognized by the CRR under the Article 416(3)(a) "assets that are unencumbered or stand available within a collateral pool…". However, the drafting of Art. 416(3)(a) is ambiguous, as it does not specify whether the counterparty should be a Central Bank.

Generally, as said, local co-operative banks do not have a direct deposit with the relevant central bank and do not have access to payment and settlement systems and capital/money markets. Therefore, they perform central bank refinancing operations through their central institution. To this end they pledge at their central institution financial assets within a collateral pool and are granted a credit line which can be drawn down in full or in part.

When local co-operative banks draw down the credit lines, the central institution performs a Central Bank refinancing operation in order to obtain funding and to this end use the assets that has been pledged by the local co-operative banks.

Therefore, we believe that, in such cases, co-operative banks should be allowed to include in the HQLA the assets that have been pre-positioned or pledged at their central institutions but have not been used to generate liquidity by drawing down the credit line.

For the inclusion of such assets among HQLA some criteria should be fulfilled:

- the assets qualify as HQLA;
- if the assets are pre-positioned to generate liquidity, when the local bank draws down liquidity from the central institution, the central institution performs a correspondent operation with the Central Bank;
- the competent authorities are satisfied that the level of integrated management, risk management and internal control mechanisms are adequate for the purposes of managing, monitoring, reporting and recording those operations.

Secured lending and capital market driven transactions

Therefore, when local banks perform operations with the relevant National Central Bank via the central institution of their network, a 0% run-off factor should be applied to liabilities resulting from such secured lending and capital market-driven transactions. These operations, in fact, reflect Central Banks' liabilities as under Art. 422(2)(e) CRR.

2. The Definition of highly liquid and liquid assets under the European LCR framework

The definition of extremely highly liquid and highly liquid assets is a key element for the design the LCR. In order to achieve a balanced rule, it is important to take into account the specificities of the EU, its financial market and of its various banking business models.

General Remarks

<u>The rule defining highly liquid and liquid assets should allow for flexibility</u>

The European definition of extremely highly liquid and highly liquid assets should provide guidance for credit institutions to identify highly liquid assets and liquid assets, while at the same time leaving enough flexibility. Otherwise, we foresee the following drawbacks:

- a very precise and descriptive definition of liquid assets would not allow to react on new instrument and to take up new development in the financial market;
- there is no definitive proof on the liquidity of securities so that too narrow definitions may appear to be arbitrary;
- since EBA's report on HQLA definition is not complete there might be other types of assets that may have to be considered;

<u>Possible market criteria</u>

- the possibility to generate liquidity by encumbering an asset easily, on a regulated market, such as Eurex (GC Pooling), should be the most important criterium for classifying an asset as level 1, irrespective of its asset class. The approach should be based on obvious market criteria (e.g. collateral eligibility, credit rating, etc.) in which the graduation of liquidity within one asset class could be implemented by different haircuts. On the other hand, we consider that the "issue size" is not an appropriate criterium. It would discriminate smaller national European markets (e.g. Austria), where a placement of so called "Jumbos" (issue size minimum 1 Bill. EUR) or even issue sizes about 500 Mill. EUR are very uncommon.
- when defining the concept of encumbrance it is essential to distinguish between a solvency perspective or a liquidity perspective. The BCBS definition correctly takes the liquidity perspective as it defines unencumbrance as *free of legal, regulatory, contractual or other restrictions on the ability of the bank to liquidate, sell, transfer or assign the asset*.

<u>Specific Assets</u>

2.1 <u>The committed liquidity facilities</u>

The Basel Committee for Banking Supervision has recently accepted Committed Liquidity Facilities granted by Central Banks as liquid assets in the LCR, but with many restrictions, thus referring to them as Restricted CLFs. These restrictions, however, are so strong that they completely hamper the use of CLFs. Indeed the 75bps pricing set by the Basel Committee penalises the use of RCLFs in Europe[2], moreover the RCLF is also limited to level 2B in the HQLA buffer, with stigmatising publication. We believe that such instrument has to be accepted as highly liquid by the Commission in the Delegated Act for the specification of the liquidity buffer, but with different conditions.

Indeed, the EBA report on the impact of the LCR on the economy seriously underestimates the LCR shortfall of the European economy, notably through failing to take into account the LTRO and the lack of demand for credit due to the recession in Europe. In any case, it is our opinion that the LCR would limit to the amount of credit that can be granted to the economy, because of the crowding out effect of buying sovereign bonds rather than granting loans to the real economy. Several papers, some by the Basel Committee itself, have also shown that the CLF may mitigate the negative impact of the LCR on the monetary policy[3]. Other high-rank officials, such as Governor Mark Carney, have clearly made a link in some of their speeches between the supply of credit in an economy and the liquidity regulation[4].

Furthermore, the CLF would allow a diversification of the risks of European banks by limiting the amount of sovereign bonds they hold.

Cooperative banks believe that the Delegated Act should not define the cost of the CLF.

We believe that the CLF should be included among Level 1 HQLA for the LCR, or at least 2A. Indeed the CLF would be as good as a deposit at the ECB and it would be of even better quality than any Eurozone sovereign bond. The inclusion among Level 1 assets would entail a number of advantages such as: a reduction of the crowding out effect of the LCR on private investments and the diversification of banks' risks, limiting the recourse to sovereign bonds. Finally, the assets to be held in order to access the CLF should be the same as those eligible for Central Banks' normal market operations.

2.2 <u>Covered bonds should be recognized as level 1 assets</u>

The EBA empirical studies of liquidity shows that covered bonds' liquidity rank at the same level as government bonds and even outperform them in a few criteria like price volatility. EBA also underlines that for covered bonds "variables capturing the existence of regulator characteristics which reduce credit risk and enhance transparency are significant predictors of liquidity".

Nevertheless, EBA recommends that covered bonds should only be recognized as level 2 assets. The argument is that two-thirds of the observations on covered bonds in the study came from countries that did not experience a real estate crisis. We do not find this

[2] The pricing for CLF is set to 15bps in Australia.
[3] For example, in BIS Working Papers N. 439, "On the economics of committed liquidity facilities", January 2014, by Morten L. Bech and Todd Keister.
[4] (see "Crossing the threshold to recovery", speech given by Mark Carney, Governor of the Bank of England on the 28th of August 2013).

argument valid. Indeed, the study rather shows that covered bonds markets actually tested in practice (one third of the sample) performed very well and largely unaffected despite the stressed financial markets and collapse in property prices.

In fact, covered bonds are subject to strict regulation, public supervision and are therefore a highly transparent asset class.

Moreover, Recital 100 CRR stresses that the inclusion of covered bonds in Level 1[5] would "promote a diversified and high-quality liquidity buffer consisting of different asset categories" and reduce the linkage between the solvency of sovereigns and the robustness of the national banking sectors which otherwise will be a result of the LCR. In addition, covered bonds are crucial for financing the real economy, and element which should be taken in consideration when highest liquidity criteria are fulfilled.

Furthermore, we would like to emphasize the importance of the use of covered bonds on EU financial markets, and their widespread use among cooperative banks. Such instruments usually have a high quality liquidity profile and represent a key tool to sustain real economy through cheaper credit.

Thus, our opinion is that covered bonds should be recognized as level 1 assets as evidenced by EBA's own empirical studies. In general including covered bonds proven almost as liquid as government bonds in the level 1 category will also mitigate the concentration risk in bank's liquidity buffer arising from setting a too narrow definition of level 1 assets. Finally, some of the conditions suggested in the EBA report are too restrictive.

2.3 Bonds issued by local governments

We strongly advocate that, under specific circumstances, bonds of regional governments and local authorities can be treated as exposures to central governments and thus be accepted among Level 1 HQLA. In fact we believe that under the LCR there should be no different treatment than under solvency requirements of the CRR. Moreover Recital 101 CRR states that the funding environments of institutions across the Union should be taken in consideration.

Art. 115(2) CRR states that exposures to regional governments or local authorities are treated as exposures to central government, "where there is no difference in risk between the two because of the specific revenue-raising powers of the former, and the existence of specific institutional arrangements the effect of which is to reduce their risk of default." We suggest that the same treatment should be envisaged for liquidity regulation purposes, as also the markets treat such securities in the same way. Finally, while the CRR does not provide a definition of "EEA sovereign", Annex III details further items to be reported as liquid assets: here are included transferable securities of "regions with fiscal autonomy to raise and collect taxes and local authorities", provided that some

[5] "When making a uniform definition of liquid assets at least government bonds, and covered bonds traded on transparent markets with an ongoing turnover would be expected to be considered assets of extremely high liquidity and credit quality"

conditions are fulfilled (e.g. they are assigned a 0% or a 20% risk weight under Chapter 2, Title II of Part Three).

Not including local governments bonds among "Sovereigns" may impact the LCR of cooperative banks in two ways: as Level 2a assets such bonds will only be eligible for recognition with a haircut (Basel III: 15%); a potential reintroduction of the cap on Level 2 assets may worsen the decrease of eligible Level 1 assets, notwithstanding the fact that there may be sufficient assets in the form of Level 2 Assets.

2.4 <u>Promotional bank bonds</u>

According to the EBA report, promotional bank bonds did not show sufficient evidence for high liquidity. Only promotional bank bonds guaranteed by a central government shall be eligible for recognition as HQLA. We believe that bonds of promotional banks which are guaranteed by regional and local governments should be eligible for recognition, provided that the criteria for local governments under the solvency approach seen above are fulfilled by the guaranteeing entity. Moreover, excluding such assets from the buffer would be incompatible with the initial regulatory rationale underlying Art. 416(2)(a)(iii) CRR which explicitly includes assets guaranteed by regional governments.

2.5 <u>Use of CIUs in the buffer</u>

Some cooperative banks are using the possibility given by the CRR text (Art. 416(6)) to constitute their liquidity buffer through CIUs investing only in liquid assets. The safeguard of this provision in the specification of the liquidity buffer is of key importance for our Members. This possibility would allow especially smaller banks to have their HQLA managed professionally and diversified in terms of maturity and risk.

Moreover, the operational conditions for the integration of these CIUs in the buffer should be defined so that it is indeed practical to use this kind of instrument. In particular, consistently with the answer given by EBA in its FAQ (Question ID: 2013_132), it should be allowed that these CIUs hold monies in deposits at credit institutions, as required for the proper management of the fund, provided that such amount remains small compared to total assets.

Moreover, we believe that the treatment of assets of individual CIUs (100% owned by a single shareholder) and those directly held by the bank should not be different. In fact, due to the 100% ownership, the respective assets can be liquidated just as well as any direct investment. The access is rather direct and there is no other investor for whom the potential sale of liquid assets could be detrimental. Therefore, a look-through approach should be allowed and the liquid assets in the individual fund should be taken into consideration even if such individual fund is not exclusively invested in HQLA (see Art. 416(6)). Otherwise massive regroupings may be required, which, particularly for smaller and medium-sized banks will imply considerably higher costs.

2.6 <u>RMBS and securitisations</u>

Likewise, other types of securitisations, especially Automobile and Lease ABS should be eligible as LCR assets in the HQLA stock. Moreover, the importance of a functioning securitization market has recently been stressed by the ECB President, Mr. Draghi.

On RMBS specifically, it should be specified that the 5 year time-to-maturity evoked in the regulation is indeed the WAL (weighted-average life).

3. Use of haircuts in place of fixed Cap on Level 2 Assets

In its report on the impact assessment for liquidity measures, the EBA recommends to maintain the cap for Level 2 Assets to be included in the liquidity buffer (limiting the Level 2 Assets to 40% max. as well as a limitation of the Level 2b assets to 15% max. We believe that this may lead to potential asset misallocations due to a lack of diversification and to concentration risk. Furthermore, such limit would impose severe restrictions on direct investments and weaken banks' risk-bearing capacity, due to insufficient opportunities for a diversification of counterparty default risk and market risk.

Such result would be in direct contradiction to recital 100 CRR, which recommends a broadly diversified buffer of liquid assets.

Clear experience during the European sovereign debt crisis has shown that a concentration of Level 1 assets on government bonds is not without risks. Considerable concentration risks may turn stress-market conditions into a crisis. Given that the market liquidity for Level 2 Assets is partly higher than for Level 1 Assets, the eligibility for issuance of Level 2 Assets could be restricted.

Furthermore, the cap also has considerable repercussions on the real economy. After all, the capital market funding options for companies will be curtailed.

Based on the above-said, we suggest to reconsider the reintroduction of the cap for Level 2 Assets. Instead of fixed caps for Level 2 and Level 2b we suggest to elaborate a system of different haircuts for asset classes, which should represent their different levels of security and liquidity, e.g. oriented on ratings. This would also steer the investment policy of banks towards assets with higher liquidity, and therefore lower haircuts, without completely limiting the funding options of the real economy.

4. Other parameters to be confirmed under the European LCR Framework

4.1 Recognition of the 3% run-off rate on retail deposits

Cooperative banks which are mainly retail banks are worried that in the European LCR framework of the Basel Committee's 3% run-off rate for stable retail deposits, introduced in the January 2013, is not reflected.

Following the different characteristics of the deposit guarantee schemes in the European Union, all retail deposits under a deposit guarantee scheme in accordance with Directive 94/19/EC should benefit from this run-off rate. This is especially relevant as the level of intermediation of European banks is much higher than in the US, with banking intermediation as an essential part of the European growth model.

European cooperative banks are concerned that this possibility is not seriously taken into consideration by EBA as we conclude from the reporting template provided at the end of July.

Identification of stable retail deposits

The cooperative banks' networks must not be penalised for their sound deposit base. After all, the stress tested and stable business relation is the centrepiece of their business model (see Annex 1). For what pertains the calculation of retail deposits outflow rates, the EBA/GL/2013/01 requires a general identification of deposits that are subject to higher outflow rates in a stressed market environment (so-called high risk deposits). To this end, in order to determine whether it shall be deemed a high risk deposit, every retail deposit will have to be assessed on the basis of eight specific risk factors using a scoring approach. Instead, in order to allocate the retail account deposits to the appropriate buckets and for an appropriate determination of the respective liquidity outflow rates, the review should first and foremost be predicated on verifying the presence of the two material criteria "established business relation" as well as "transactional account".

There should only be a review of the risk factors and thus a potential assignment to higher outflow rate buckets if and when there is a failure to meet the criteria of an "established business relation" as well as a "transactional account". Given the specificity of the customer relation in the cooperative sector (most clients are simultaneously shareholders) we are of the opinion that membership in a cooperative bank is usually also a sign of an established business relationship.

The proposed EBA methodology is burdensome and seems not consistent. In fact, it dictates an a-priori risk classification of the deposits based on the combination of 9 factors, while asking the institutions to determine appropriate run-off rates. Such methodology should be reviewed to allow for a consistent and sound implementation.

Especially for small co-operative banks, the collection and the assessment of the relevant data and the proposed categorization, will result overly complex and costly to be implemented in IT systems. Therefore, the costs of the methodology proposed are likely to outweigh the benefits. Given the costs and the complexity of implementing the proposed methodology, there might be the case of banks not being able to fully apply those guidelines. Small banks should be allowed to classify all relevant deposits within one only bucket (e.g. the third bucket described in the Draft GL) and an appropriate minimum outflow rate for that bucket could be provided by the EBA or assigned to national discretion.

4.2 <u>Symmetrical treatment of internal flows within groups</u>

In the current European framework, a lot of asymmetries exist in the treatment of internal flows notably concerning off-balance-sheet items.

It is particularly important that all internal flows are granted a symmetrical treatment under the LCR framework. Indeed, any other approach would have the following drawbacks:

- unjustified (and currently not measured) increase in the LCR shortfall of the European economy;
- great difficulties to manage some internal contracts within banks, especially in cooperative networks, due to the very high amount of links between the central institution and the local institutions;
- supervisors should however be given the right to modify the outflow and inflow rates applied on internal deals. This would be the case, for example, if the supervisor decides to allow the group to manage its internal LCR through liquidity facilities, in which case a 100% inflow and outflow rate should be granted, instead of only the asymmetric 40% outflow rate without any inflow. In January 2013, in fact, the Basel Committee mapped 40% liquidity outflow factor to unused interbank committed liquidity lines (Paragraph 131(d)). In case of cooperative networks if the liquidity lines provided by the central institution to the member organisation cannot be treated as liquid assets, they are nevertheless part of the internal counterbalancing capacity. They should therefore enjoy a symmetrical treatment, with the undrawn part of the committed line to be regarded as an inflow, with the same factor, for the member institutions. This would allow a more consistent management of internal liquidity.

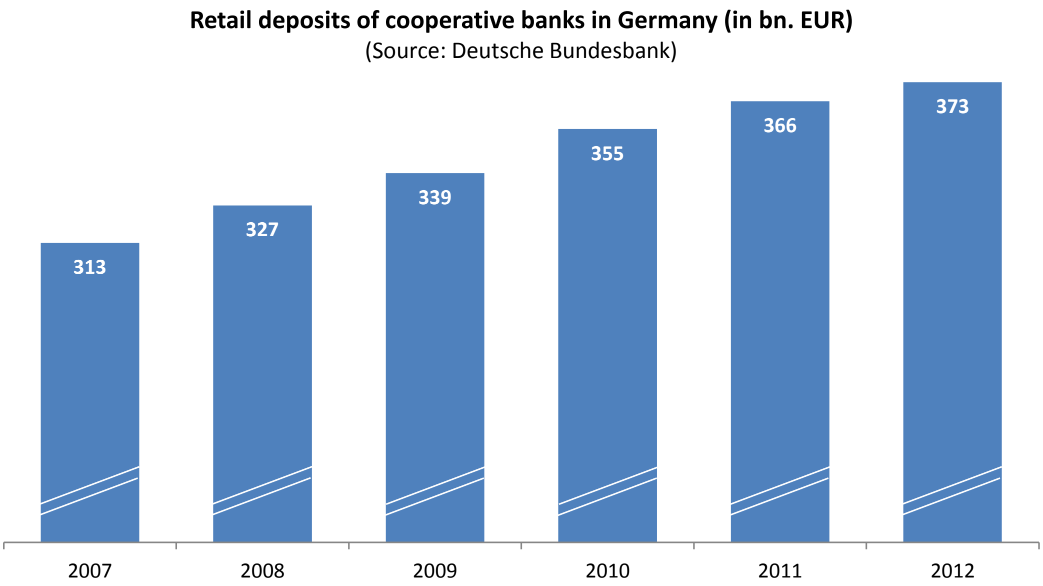
4.3 <u>Derogations from the inflow cap</u>

We strongly advocate for maintaining under the framework of the LCR the provision under Art. 425(1) CRR, which exempts deposits constituted within groups and institutional protection schemes from the cap on inflow rates.

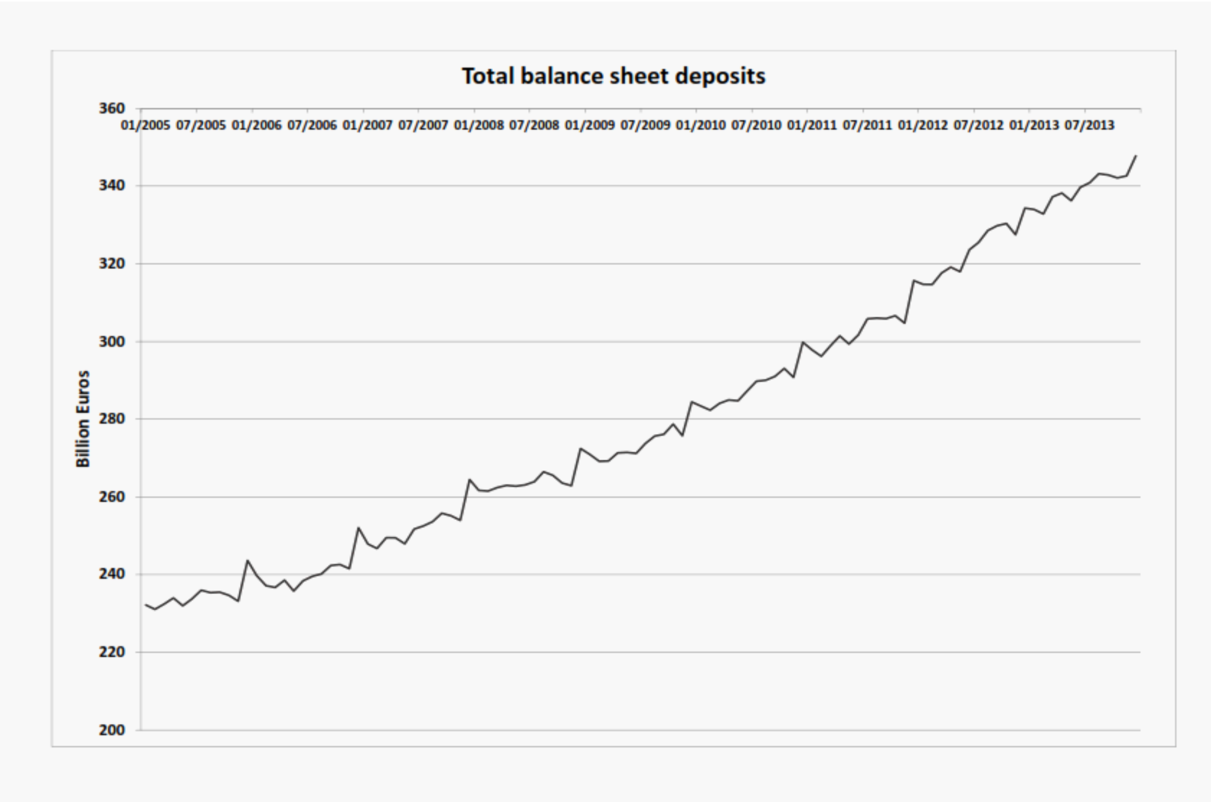
Moreover, in the impact assessment EBA concludes that some business models, e.g. pass-through financing, should be exempted from the 75% cap on cash inflows. In the CRR several other types of inflows are exempted from the inflow cap, e.g. flows from deposits placed under private guarantee schemes, flows related to mortgage lending funded by covered bonds and group internal flows.

It is important that these derogations are recognized in the final European LCR framework. Indeed, all cash inflows contractually available within 30 days and with no reason for not expecting them to be paid (unless non-performing) – especially if it is reserved certain debtors expecting a corresponding cash outflow within 30 days – should be considered almost as liquid assets, i.e. not reduced by the inflow cap.

Annex 1



Graph. 1



Graph. 2

Total balance sheet deposits of regional banks of Credit Agricole