



To the Basel Committee of Banking Supervision

CONSULTATION PAPER ON INTERNATIONAL FRAMEWORK FOR LIQUIDITY RISK MEASUREMENT, STANDARDS AND MONITORING

The Federation of Finnish Financial Services (FFFS) welcomes the opportunity to respond to the Committee consultation on the above mentioned topic. FFFS is a member of European Banking Federation. While supporting the views put forward in the EBF's response, the FFFS respectfully submits the following additional comments.

1. General comments

We believe that the proposals in the Committee paper lack a number of key features and have many uncertainties. In its present form it would also create disincentives for banks to improve their risk management practices and would allocate their resources inefficiently to seek loopholes and benefit regulatory arbitrage.

We believe that the proposals would also need to be reconsidered in light of the far-reaching consequences which they will have not only for the banking industry but for the customers and the real economy as a whole. We note that particularly in smaller countries, like Finland, the bank lending is often the only source of finance for SME businesses as well as large companies. Introducing proposed rules would limit the banks' capacity to lend which in turn would reduce corporate sector's ability to make new investments. Particularly under current economic cycle, this would substantially slow the economic recovery and weaken the basis for growth also in the longer term.

The proposal has not carefully considered the negative interplay between two basic liquidity meters neither in this paper nor in respect of the proposals in the consultation paper on the strengthening the resilience of the banking sector. One example of the latter is the interplay with the leverage ratio. According to the proposed liquidity coverage ratio, banks will be required to hold buffers comprising mainly government securities and other non - risky assets. These buffers are also proposed to be counted as part of the leverage ratio, which constrain banks' balance sheet growth. As a result, banks are required to hold more assets with low yields which in turn reduce their lending capacity. It is therefore essential that the assets required to be held within the new liquidity requirements need to be deducted from the denominator of leverage ratio.

We believe the main problem of the proposal is that is trying to have one size fit's all solution for all banks and contingencies. This is not in line with the development elsewhere in the Basel 2 framework. We find it important that the regulatory liquidity risk management framework would need to take into account broader bank's own liquidity risk assessment.



We are strongly against the proposal that “national authorities are free to adopt arrangements that set higher levels of liquidity”. This is not in line with the aiming to ensure global level playing field. We would like to suggest adopting a pillar 2 like approach which would encourage banks to develop adequate internal quantitative frameworks to measure liquidity risk

Against this background, it would be necessary to assess carefully the results of the ongoing impact study and open a second consultation subsequently before final decisions of the rules will be made. We also find it important that impact study will include an analysis on all the factors mentioned above.

It is necessary that the Committee will put in place appropriate phase-in measures and grandfathering arrangements for a sufficiently long period to ensure a smooth transition to the new standards.

2. Impacts of the proposals

The proposal will have a substantial impact on the banks' capacity to lend as the funding used to meet the ratios cannot be used for lending to consumers and business.

Particularly the outcome that financial instruments which are issued by financial institutions are not included in the eligible asset classes will put severe price constraints on banks' funding as well as weaken the quality of their balance sheets. The narrow definition of eligible assets will also limit the willingness of interbank lending and reduce the flows in the interbank market (further reducing available credit in the economy). As a result, increase interbank rates will likely raise and necessarily be passed on to customers.

Implementing the proposed requirements will imply a huge burden and will in particular be troublesome for smaller banks who may leave totally the market, further reducing available credit.

The new framework will result in a higher demand for those assets which are eligible for the liquidity buffers. This may in principle have positive consequence for externally rated large international companies' funding alternatives. However, proposed rules would have negative outcome for Finnish type bank dependent SME sector (see above), which have no alternative sources of funding. Simultaneously SME companies could be facing competitive disadvantage against large companies

By penalizing transactions with other banks would increase transactions with unregulated entities, i.e. outside the supervisory framework. This is a paradox and, moreover, likely to increase systemic risk.

3. Specific comments

Proposed methodology based on the hard quantitative metrics

We agree that the monitoring, management and control of liquidity requires institutions and regulators to look at a number of metrics. However, we strongly believe that sound liquidity risk management primarily needs to be based on the bank's own liquidity risk assessment. Against this backdrop, we would like to suggest adopting a pillar 2 like approach which would encourage banks to develop adequate internal quantitative frameworks to measure liquidity risk which fully capture the liquidity risk to which they are exposed. Those internal frameworks



would need to be validated by the supervisors on the basis of criteria which should be transparent and flexible. Moreover, supervisors would make use of the quantitative standards proposed in the consultation paper as a benchmark – meaning that those will apply except if the firm demonstrates to the satisfaction of its supervisor on the basis of behavioural overlays that the run-off factors would need to be refined.

Furthermore, the quantitative standards proposed in the Consultation Paper should be imposed as a minimum standard on those banks which fail to set up an adequate internal quantitative framework, and only on them.

Particularly we support a non-binding firm-specific approach to NSFR allowing risk-based assumptions and parameters. Alternatively underlying scenario in NSFR should be based on business-as-usual mode. We can't support the current proposal, as it gives no consideration to potential adjustments that firms would make to their strategy and balance sheets during a one year stress scenario, thus imposing unrealistic parameter assumptions and would eliminate banks' ability to perform maturity transformation.

Definition of the high quality liquid assets

In aiming to ensure well functioning markets, we support the broader definition of liquidity buffers. Particularly it is important that the assets which are central bank eligible would be included in the high quality liquid assets. The consultative paper doesn't give any clear explanation to exclude such items. Providing liquidity facilities as influencing liquidity within markets is a basic role of central banks and an essential tool within their monetary policy framework. We strongly believe that it would be unreasonable to imply that central banks cannot be accepted as part of the liquidity support if a market-wide stress event would occur.

We also believe that the definition of liquid assets should cover more widely covered bonds. The proposed hair cuts for covered bonds are too high and do not reflect the markets behaviour during crisis. Cutting off covered bonds would have negative impact on the real estate lending and housing market in general in many countries. Furthermore, we don't support the idea to exclude a covered bond from the stock when it issued by the bank itself but not when it is being held by another bank

Proposed run-off parameters

We believe that the proposed run off parameters for deposits are too rigid and prescriptive. Moreover, they are not supported by any fact finding exercise or behavioural assumptions. While it's likely that all institutions will face both institution-specific and systemic shocks during acute liquidity stress, it's not clear that all of the suggested shocks materialize for all institutions in a similar manner. E.g. during the financial crisis in 2008, some Finnish institutions faced an increase of retail deposits, not run-off. We point out that systemic shocks defined in the Committee's paper paragraph 22 item (c)-(e) are the ones most likely to hit all institutions. Institution-specific shocks might even be determined by national authorities in the pillar 2 process.

Level of application

We stress that the new framework for liquidity risk management should be applied on a group level. This is particularly a concern to groups that have efficiently operated on a centrally managed liquidity model. We welcome EU Commissions initiatives to clarify the issue giving



opportunity to centralised liquidity risk management when special conditions are met. We strongly believe that centralised liquidity risk management should be allowed within the highest group level to consolidated groups as well as corresponding consortiums which are supervised on a consolidated basis by the local FSA. Without this waiver trapped pools of liquidity and double counting of liquidity risk could occur if there is an asymmetry of treatment of intra-group exposures, leading to an ineffective use of liquidity and thereafter reduced liquidity in the economy.

Transitional arrangements

It is necessary that the Committee will put in place appropriate phase-in measures and grandfathering arrangements for a sufficiently long period to ensure a smooth transition to the new standards.

Even if the proposed framework is substantially amended to meet the various concerns expressed by stakeholders, a transition period spanning some years would be required to allow banks to build up their liquidity buffers and, in particular, their long-term funding to meet the NSFR requirement and, furthermore, make sure that most of the collateral that does not meet the narrow definition has matured and can be substituted by qualifying financial instruments. Part of the solution for the transition might be to phase in the new requirements and, more particularly, apply low percentages initially and increase those gradually over time.

FEDERATION OF FINNISH FINANCIAL SERVICES

Piia-Noora Kauppi
Managing Director