

EBA/CP/2021/29

16 July 2021

Consultation Paper

Draft Amending Implementing Technical Standards

on currencies with constraints on the availability of liquid assets in accordance with Regulation (EU) No 575/2013 of the European Parliament and of the Council

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1. Responding to this consultation

The EBA invites comments on all proposals put forward in this paper.

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 16 October 2021. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if 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 (EU) 1725/2018 of the European Parliament and of the Council of 23 October 2018. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive Summary

Article 419 of Regulation (EU) No 575/2013 of the European Parliament and of the Council ('CRR') specifies a number of derogations applicable to currencies with constraints on the availability of liquid assets for the purpose of the calculation of the Liquidity Coverage Ratio (LCR). As part of the Risk Reduction Measures (RRM) package adopted by the European legislators, an additional derogation was added. The derogations of Art 419 of the CRR 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.

The EBA has been tasked to amend the existing Regulatory Technical Standards (Commission Delegated Regulation (EU) 2016/709 of 26 January 2016) specifying the use of derogations and the conditions of their application following the addition of a new derogation, with a concomitant need to update the corresponding Implementing Technical Standards (Commission Implementing Regulation (EU) 2015/2344 of 15 December 2015) on the effective list of currencies with constraints, which currently consists of one single currency, the Norwegian Krone (NOK).

The draft Implementing Technical Standards (ITS) of this consultation paper propose to amend Commission Implementing Regulation (EU) 2015/2344 of 15 December 2015, by removing NOK from this list. The reason is the change in the supply of and demand for NOK denominated liquid assets since the assessment underlying the existing ITS. Given that there is no longer a shortage in the supply of liquid assets in the NOK currency, the derogations are no longer deemed necessary.

To keep regulatory efforts in proportion to the impact, since it is proposed to have no currencies on the list, the EBA will not update the Commission Delegated Regulation (EU) 2016/709 that specifies the conditions for the application of the derogations. Such an update will be proposed if during a future assessment it is observed that a currency will have to be added to the list.

Next steps

The consultation paper will be outstanding till 16 October 2021. The final amending implementing technical standards are foreseen to be submitted to the European Commission by the end of the year.

3. Background and rationale

1. Article 419 of the Capital Requirements Regulation (CRR – Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013) relates to currencies with constraints on the availability of liquid assets for the purpose of the calculation of the Liquidity Coverage Ratio (LCR). This article has been amended through the RMM package (Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019) to introduce an additional derogation for concerned currencies. There are three derogations available, namely to allow the use of liquid assets denominated in a foreign currency, the use of specific credit lines committed by the relevant central bank as liquid assets, and the use of additional level 2 liquid assets to meet the LCR. 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.
2. The Implementing Technical Standards (ITS) of Article 419(4) of the CRR (Commission Implementing Regulation (EU) 2015/2344 of 15 December 2015), list currencies 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 of the CRR exceed the availability of those liquid assets in a currency. Currently, the list in the ITS, which is to be amended by the draft amending ITS of this consultation paper, consists of one currency, the Norwegian Krone (NOK). The list of currencies in the existing ITS has been specified on the basis of data gathered by the concerned jurisdictions and a set of assumptions that result in shortage estimates per currency.¹
3. The ITS is to be read together with Regulatory Technical Standards (Commission Delegated Regulation (EU) 2016/709 of 26 January 2016) stemming from a mandate to the EBA in Article 419(5) of the CRR. The RTS specify the use of derogations and the conditions of their application. The EBA has been mandated to amend the existing RTS specifying the use of derogations and the conditions of their application, with a concomitant need to update the corresponding ITS on the effective list of currencies with constraints.
4. In developing the work for both the RTS and ITS, the EBA has come to the conclusion that the Norwegian Krone can be removed from the existing list of the ITS, which would leave the list with no currencies with constraints in liquid assets. As a result, the need to amend the RTS on the basis of the additional derogation introduced in the CRR becomes void at this point in time since the amended RTS would not have any application in practice.

¹ <https://www.eba.europa.eu/regulation-and-policy/liquidity-risk/draft-technical-standards-ts-on-currencies-with-constraints-on-the-availability-of-liquid-assets>

3.1 Methodology applied for the existing ITS

5. In the course of 2013 and 2014, to determine the supply of liquid assets, the EBA collected data from the jurisdictions using the Basel definition of high quality liquid assets (HQLA), as laid down in the standard of the Basel Committee on Banking Supervision of 7 January 2013 regarding the liquidity coverage requirement ('BCBS standards'). The incorporation of the Basel definition was deemed necessary as a definition of liquid assets was not yet established within the context of the CRR.
6. On the demand side, the concerned jurisdictions reported the estimated demand for liquid assets from institutions regulated by the CRR as the weighted net cash outflows over the next 30 days, taking into account the cap on inflows. In the absence of a formal mandatory reporting requirement prior to the application of the CRDIV/CRR, estimated demand was based on information reported in the EBA's voluntary reporting exercise and/or in the Quantitative Impact Study of the Bank for International Settlements (BIS). The latest reported information available during the assessment process was dated September 2012, so estimated demand did not reflect the changes in the BCBS standards of January 2013 or any possible behavioural effects. For countries that did not participate in the BIS Quantitative Impact Study, the reporting of demand was based on other available sources.
7. To assess the amount of liquid assets locked up by investors not regulated by the CRR, the concerned jurisdictions reported holdings of liquid assets by these entities, and provided evidence that these holdings were price inelastic but stable. To ensure the robustness of the results, a sensitivity analysis was conducted to account for uncertainties in the supply and demand figures. The analysis estimated, inter alia, the impact of potential deviations from the Basel definition of liquid assets and of scenarios in which the supply of government debt would grow. These analyses helped inform the EBA in its view that the abovementioned approach leads to appropriately robust results.
8. It is to be noted that Article 7 of the Commission Delegated Regulation (EU) 2016/709 specifying the conditions for the application of the derogations concerning currencies with constraints on the availability of liquid assets, contains a limit to the total use of the derogations by institutions, which equals the relevant shortfall percentage in the annex of the ITS. This percentage (63% for NOK) indicates the estimated aggregate shortfall compared to the aggregate demand generated by the liquidity coverage requirement for each currency on the list. The idea 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 liquid assets as defined in Delegated Regulation (EU) 2015/61. This restriction is in addition to the general requirement of taking all reasonable steps to fulfill the LCR requirement before applying the derogation.

3.2 Update regarding NOK

9. The update regarding NOK is warranted given the period of time since the initial assessment and the improved availability of data on demand for liquid assets resulting from the liquidity coverage requirement. Data availability improved pursuant to the implementation of common reporting on the liquidity coverage requirement in the supervisory reporting framework (this amendment to the Commission Implementing Regulation (EU) No 680/2014 was implemented by end 2016).

10. Just as for the assessment underlying the existing draft ITS, the new proposal for a(n empty) list of currencies has been specified on the basis of a comprehensive data analysis. In specific, the Norwegian FSA has provided data on the following:

- 1) Supply of liquid assets (size of the market). This is provided per type of liquid asset and level. For example the amount of outstanding Level 1: Central government assets. The source of the data is mostly the Norwegian Central Securities Depository as observed at the start of April 2021. In case of withdrawable central bank reserves it is Norges Bank (average amount regarding 2021 up to the start of April) and in case of coins and banknotes it is LCR reporting (end of February 2021 reference date).

This has led to the following overview of (gross) supply of liquid assets is as follows (all in bn NOK):

Level 1: Central government assets	536.0
Level 1: Coins and banknotes	1.4
Level 1: Covered Bonds	596.8
Level 1: PSE, Regional, Multilateral development bank and international organisations as	288.1
Level 1: Withdrawable central bank reserves	15.0
Level 2A: Covered Bonds	96.8
Level 2A: Regional government / local authorities assets / PSE (RW20%)	152.7
Level 2B: Corporate debt securities (CQS2/3)	36.6
Level 2B: Shares (major stock index)	1,048.8

- 2) Estimated demand from non-CRR institutions. This is provided per type of liquid asset and level on the basis of data from the Norwegian Central Securities Depository. The categories include a) Domestic insurance, government fund, pension funds, mutual funds owned by insurance, b) Foreign investors (Non-CRR), c) Other demand from Norwegian long term investors (Non-CRR) (for example including municipalities).
- 3) Estimated demand from CRR institutions (domestic and foreign) on the basis of LCR reporting, as measured by total net outflows in May 2020 (the reference date on which the maximum amount observed between December 2019 and February 2021).

11. The shortfall calculation, in line with the analysis in 2013, should generally be performed in five steps:

- Step 1: A deduction of demand from non-CRR institutions from supply for each level (level 1 without covered bonds, level 1 covered bonds, level 2a, level 2b). The general assumption is that holdings by non-CRR institutions are stable/locked-up (also based on regulation for these sectors). This step yields the following results (all in bn NOK):

	Supply (gross)	(-) Demand: Domestic insurance, govt.fund, pension funds, mutual funds owned by insurance (Non-CRR)	(-) Demand: Foreign investors (Non-CRR). Only 50% is represented as this is proxy for share of Non-CRR institutions)	(-) Demand from other Norwegian long term investors (Non-CRR)	Supply (available to CRR institutions)
Level 1 (non covered bonds)	840.5	58.9	165.2	79.2	537.2
Level 1 (covered bonds)	596.8	62.4	40.7	2.5	491.3
Level 2A	249.5	101.0	17.6	4.5	126.4
Level 2B	1,085.4	30.8	207.5	289.1	557.9

- Step 2: Application of the haircuts and caps to each level, leading to the amounts of liquid assets that could be used if all banks were using their caps optimally. This step results in the following amounts (all in bn NOK):

	Supply (available to CRR institutions) after haircuts	Supply (available to CRR institutions) after application of the caps
Level 1 (non covered bonds)	537.2	537.2
Level 1 (covered bonds)	456.9	456.9
Level 2A	107.4	107.4
Level 2B	279.0	194.4
Total supply:		1,295.9

- Step 3: Multiplication of CRR institution net outflow by 110% assuming they would target a 110% LCR, which results in the following amounts:

	Demand CRR institutions (100% LCR)	Demand CRR institutions (110% LCR)
From Norwegian credit institutions	467.9	514.7
From foreign credit institutions	390.3	429.3
From all credit institutions	858.2	944.1

- Step 4: Comparison of the total demand in the previous step with the amount of capped liquid assets (the difference is the shortage).
- Step 5: Addition of +25% to the shortage percentage of the previous step. This is an estimate of the amount of free-floating assets required for a market to remain liquid.

The combination of step 4 and 5 leads to the following:

Shortage (surplus if -) assuming 110% LCR (NOK bn)	-351.79
Shortage (surplus if -) compared to 110% LCR needs	-37.3%
Shortage (surplus if -) after addition of 25% (to keep markets liquid)	-12.3%

12. The tentative conclusion from this calculation is that there is no place on the list warranted for NOK any longer.

13. There are several sensitivities that can be tested, particularly where a part in the calculation could be subject to debate. One such an aspect is the assumption about the share of the amount of liquid assets held by foreign institutions that is non-CRR. In the above calculation it is assumed, in line with the observation in 2013 regarding domestic institutions, that 50% of these foreign institutions are non-CRR (at least regarding government bonds). Currently, making a more accurate assessment we observe that this percentage is 60% regarding government bonds, 27% regarding covered bonds, and 99.5% regarding stocks. This means that slightly more government bonds may be assumed to be locked up and slightly less stocks (compared to the earlier rough assumption of 50%).

14. However, also after testing sensitivities to assumptions there is no potential shortage to be perceived, a place on the list for NOK does not seem to be warranted anymore.

4. Draft amending implementing standards

COMMISSION IMPLEMENTING REGULATION (EU) .../...

of **XXX**

amending the implementing technical standards laid down in Implementing Regulation 2015/2344 as regards currencies with constraints on the availability of liquid assets in accordance with Regulation (EU) No 575/2013 of the European Parliament and of the Council

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

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

Having regard to 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 648/2012², and in particular third subparagraph of Article 419 thereof

Whereas:

- (1) Commission Implementing Regulation (EU) 2015/2344, which is amended by this Regulation, was based on EBA's identification of the Norwegian krone (NOK) as a currency with constraints on the availability of liquid assets. That identification was made before the entry into force of Delegated Regulation (EU) 2015/61, where EBA assessed the availability of liquid assets in accordance with the international standards adopted by the Basel Committee on Banking Supervision.
- (2) On the basis that justified needs for liquid assets and availability of liquid assets have evolved since EBA's first assessment as well as to account for the fact that the Delegated Regulation (EU) 2015/61 establishes a broader range of liquid assets in particular in relation to covered bonds, the EBA has performed an updated assessment.

² OJ L 176, 27.6.2013, p. 1.

- (3) As for the first assessment, the reassessment examined the amounts of liquid assets not required by entities which are not subject to Regulation (EU) No 575/2013 and compared this to the needs of institutions, based on their estimated weighted net cash outflows over the following 30 days, taking into account the cap on inflows, factors likely to affect the shortage of liquid assets over a three to five year period and a target of 110 % for the liquidity coverage requirement.
- (4) In contrast to the first assessment, the updated EBA assessment concluded that the justified needs for liquid assets does no longer exceed the availability of liquid assets in NOK. While the supply of Norwegian government debt is still relatively constrained because of the favourable budgetary position, the supply of covered bonds, which can be recognised as level 1 liquid assets, is relative large.
- (5) Commission Implementing Regulation (EU) 2015/2344 should therefore be amended accordingly.
- (6) This Regulation is based on the draft implementing technical standards submitted to the Commission by the the European Banking Authority.
- (7) The European Banking Authority has conducted open public consultations on the draft implementing technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the advice of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council³.

HAS ADOPTED THIS REGULATION:

Article 1

Amendments to Delegated Regulation (EU) No 2015/2344

Implementing Regulation (EU) No 2015/2344 is amended as follows:

- (1) The Annex containing the list of currencies with constraints on the availability of liquid assets is replaced by the following:

³ 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 (OJ L 331, 15.12.2010, p. 12).

‘ANNEX

List of currencies with constraints on the availability of liquid assets

No.	Currency	Amount by which justified needs for liquid assets exceed availability
-	-	-

Article 2

Entry into force

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*

On behalf of the President

[Position]

5. Accompanying documents

5.1 Cost-benefit analysis

1. Article 15(1) of the EBA Regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council) provides that when any draft implementing technical standards developed by the EBA are submitted to the European Commission for adoption, they shall be accompanied by an analysis of ‘the potential related costs and benefits’. This analysis should provide an overview of the findings regarding the problem to be dealt with, the solutions proposed and the potential impact of these options.

2. This note outlines the assessment of the impact of the draft amending ITS regarding currencies for which the justified demand for liquid assets exceeds the availability of those assets. The draft ITS are a result of the requirement set out in Article 419(4) of the CRR.

A. Problem identification

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

3. 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 greatly undermined the financial health of many others, threatening financial stability and resulting in unprecedented levels of central bank liquidity and government support.

4. The CRR establishes two minimum standards for funding liquidity to address this issue: one with short term horizon (the liquidity coverage ratio - LCR) and one with mid-term horizon (the net stable funding ratio - NSFR) The LCR, is intended to ensure that an institution has sufficient high quality liquid assets (HQLA) to survive an acute stress scenario lasting for 30 days.

5. To meet the liquidity coverage requirement, institutions must hold a stock of HQLA to cover the total net cash outflows over a 30-day period. These assets should be liquid in markets during a time of stress and, in most cases, be eligible for use in central bank operations. However, the Regulation considers the possibility that in some jurisdictions there are not enough HQLA available: the Article 419 of the CRR allows institutions to derogate from the liquidity coverage requirement in case of constraints on the availability of liquid assets denominated in a given currency In the past years and on the ground of the data available at the period, the EBA was able to identify such constraints as regards the assets denominated in NOK. Recently the EBA reviewed such analysis also leveraging on more robust data stemming from the Regulatory Data Collections.

Issues addressed by the technical standards

6. The CRR mandates the EBA to develop draft ITS listing the currencies with constraints on the availability of liquid assets. For all the currencies listed, the derogations to the liquidity coverage requirement set out in Article 419(2) of the CRR shall apply.

Methodology used and technical option chosen

7. The EBA has developed a methodology based on the comparison of the estimated demand and supply of liquid assets to establish in which currencies a shortfall in liquid assets may exist. The EBA has also assumed that a buffer of free-floating assets of 25% of the estimated HQLA demand would be appropriate to maintain a sufficient level of liquidity in the financial markets under analysis. The methodology assumes that institutions target a liquidity coverage requirement of 110% reflecting the fact that institutions may aim to hold liquid assets in excess of the minimum required.

8. When the estimated demand for HQLA, incorporating the buffer of free-floating assets and the excess holding of liquid assets, exceeds the estimated supply of HQLA, the derogations to the liquidity coverage requirement set out in Article 419(2) of the CRR shall apply.

B. Impact

Costs

9. The process of determining the eligibility of currencies is based on data available at the national supervisory authorities and will not cause additional costs for institutions.

10. On the ground of previous analysis, the EBA identified only one EU currency for which the availability of liquid assets was insufficient to cover the potential demand i.e. the NOK. Updating this analysis, the EBA concluded that such constraint was not binding anymore. In particular, also under the hypothesis that the target coverage ratio is higher than the regulatory minimum, the EBA estimated an excess (supply higher than the demand) of assets equal to 350 bn of NOK. For this reason, it is now proposed to remove the derogation provided by the Article 419 CRR also for this currency.

Benefits

11. The pre-set methodology by which these ITS have been determined will ensure that currencies with a shortfall in liquid assets are identified on a consistent basis. It will also ensure that institutions operating in these currencies may use the derogations to the liquidity coverage requirement to meet their liquidity requirements, where appropriate. The methodology includes the assumption that a buffer of free-floating assets of 25% is necessary to avoid the liquidity coverage requirement impeding the liquidity of the financial markets in which those institutions operate.

5.2 Overview of questions for consultation

Question 1: Are the proposed amendments appropriate and sufficiently clear?