German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

GBIC Comments on ECB's Guide to the internal liquidity adequacy assessment process (ILAAP) – March 2018

Register of Interest Representatives

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 1,700 banks.

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The German Banking Industry Committee (GBIC/DK) is pleased to participate in the ECB's Public consultation on the draft ECB Guide to the internal liquidity adequacy assessment processes (ILAAP)

We wish to point out that the terms "adverse scenarios" and "stress tests" should not be used interchangeably. As a matter of fact, a wide range of institutions in the German Banking sector differentiates between stress and adverse scenarios in the economic perspective.

Paragraph 20. GBIC Comment: Clarification

As to the provision of the assessment of the liquidity adequacy, please clarify what is to be understood by 'backed by information it considers relevant'.

Paragraph 27. GBIC Comment: Deletion

This requirement goes too far and we urge its deletion. As a minimum, we are seeking clarification as to how ILAAP outcomes regarding risk quantification and liquidity allocation should be transposed into key performance benchmarks and targets.

The way the ILAAP outcomes regarding risk quantification and liquidity allocation are used by senior management should be at the discretion of the management body, at least in terms of the definition of key performance benchmarks and targets against which each (risk-taking) division's financial and other outcomes are measured.

Paragraph 33. GBIC Comment: Amendment

Please reword this paragraph in order to avoid an inappropriate requirement triggered by secondary actions in day-to-day risk management and caused by continuous adjustment of a document which sets out measures to be implemented in an exceptional case (recovery).The following requirement is not feasible: "Moreover, potential management actions in the ILAAP are expected to be reflected without delay in the recovery plan and vice versa to ensure the availability of up-to-date information."

The overview of all recovery measures in the recovery plan should be updated once a year. The requirement to reflect them "without delay" would preclude adequate governance procedures at banks. The planning of recovery measures is not a day-to-day risk management task.

We suggest rewording this passage as follows:

"Moreover, potential management actions which have a significant effect on ILAAP management are expected to be reflected in the recovery plan within an appropriate timeframe."

Paragraph 44. GBIC Comment: Clarification

A liquidity plan and a funding plan are two different concepts. Moreover, it could be sufficient for an institution to use a funding plan that covers the short term. In this case there would be no need to additionally establish a liquidity plan. In case there are two different plans, there should be a clear distinction between them. Hence the wording of this paragraph should read "The liquidity and funding plans ***are*** expected to comprise baseline and adverse scenarios and to cover a forward-looking horizon which is expected to capture ***twelve months for the liquidity plan and*** three or more years ***for the funding plan. It is also possible to integrate the liquidity plan into the funding plan***".

A scenario-based funding plan will help to guarantee that there is sufficient liquidity over the medium and long-term, whereas the liquidity plan is a short term concept. Paragraph 44 does not sufficiently distinguish between these two concepts. The new ECB guide implicitly requires banks to make projections of their LCR under baseline and adverse scenarios over the following three years. According to BCBS 238, the objective of the LCR is to "promote the short-term resilience of the liquidity risk profile of banks by ensuring that they have sufficient HQLA (high-quality liquid assets) to survive a significant stress scenario lasting 30 calendar days." The LCR scenario already includes a "combined idiosyncratic and market-wide shock" resulting in a loss of refinancing capacity and various additional outflows on a scale never before experienced, even during the Lehman Brothers crisis. A three-year projection under adverse future developments – as required in figure 2 on page 16 – would not, therefore, deliver any additional information, but would merely extend the stress horizon by three years.

To ensure the availability of sufficient liquidity over a longer time horizon, a new regulatory ratio was introduced in the form of the NSFR. In the words of the European Commission, compliance with the NSFR "indicates that an institution holds sufficient stable funding to meet its funding needs during a one-year period under both normal and stressed conditions" (recital 38, COM(2016) 850 final dated 23.11.2016).

In addition, the LCR can be influenced at short notice since the ratio is heavily dependent on short-term operations (repos and unsecured money-market transactions, for instance). Owing to these factors, long-term LCR forecasts can be neither realistic nor reliable. For this reason, we suggest dropping the idea of requiring any LCR projection beyond the one-month period already covered. The NSFR should be used for long-term projections. The long-term horizon is also covered by the additional monitoring metrics and maturity ladder already reported to supervisors.

The requirements of this paragraph should already be met if an institution uses the EBA harmonised funding plan for internal purposes.

Paragraph 45. GBIC Comment: Clarification

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The requirements of this paragraph should already be met if an institution uses the EBA harmonised funding plan for internal purposes.

Paragraph 47. GBIC Comment: Clarification

The effect or effectiveness of management actions in considered scenarios or stress tests should be clarified as a possible additional task.

It should be clarified that the results of adverse scenarios should primarily be considered without taking into account management actions. In particular, in our view Figure 2 creates the impression that scenario results should be calculated with consideration given to management action. However, management actions have a compensating effect, so this could dilute the calculated results of stress tests or scenarios.

Paragraph 48. GBIC Comment: Clarification

The normative reference should be added.

Example 3.1 presumably refers to Article 23(1)(d) of Delegated Regulation (EU) No. 2015/61. This Article should therefore also be cited.

Paragraph 51. GBIC Comment: Amendment

Please reflect or state the influences of different types of business models for the definition and identification of material risks.

In particular the aspect of significant capital market funding should be explicitly mentioned regarding the evaluation of the materiality of liquidity risk, e.g. resulting from significant market-oriented new products or business activities, in contrast to customer driven activities.

Paragraph 54. GBIC Comment: Deletion

This requirement should be deleted in order to avoid inappropriately singling out shadow banking entities as a source of liquidity risk.

It is understandable that supervisors wish to have an overview of banks' exposure to shadow banking entities. Given the EBA's negative definition of "shadow banking entities", we assume it would cover unregulated financial market participants such as hedge funds, private equity companies and fintechs. Since there is already an appropriate EBA guideline (EBA/GL/2015/20) to address these questions, there is no need to take any further action.

Furthermore, we would like to point out that, in terms of shadow banking, the focus usually lies on the credit exposure and other effects on ICAAP measures. It is highly questionable whether business with shadow banks generates greater liquidity risk than business with other types of borrowers such as emerging market states, construction firms, project finance, large corporations, or business partners in general with non-investment-grade ratings, etc. Moreover, we doubt that the insight thus gained will offer any added value beyond that provided by the list of exposures to shadow banks already required.

We therefore suggest dropping the requirement for separate reporting of liquidity exposures to shadow banking entities.

Paragraph 56. GBIC Comment: Clarification

This requirement is too restrictive*.*

Since the regulatory risk taxonomy has become exhaustive in recent years, it should be sufficient in some cases for the expected internal risk taxonomy. Hence the paragraph should read "... the institution is responsible for defining its own internal risk taxonomy. It is expected not to simply adhere to a regulatory risk taxonomy, ***but rather to make every effort to identify additional risks that might not be included in the regulatory risk taxonomy."***

Moreover, there is not such a diverse range of risks in ILAAP compared with ICAAP. Any variety results more from the design of the individual products and services, although there is no requirement to disclose these individually as risk types in an inventory. The systematic implementation of this concept would result in unnecessary bureaucracy without any added value for liquidity management.

Paragraph 59. GBIC Comment: Clarification

Drafting is too restrictive in terms of contracts.

In terms of the behavioural analysis, there should be no requirement to look down to the level of each individual contract. The focus of the ILAAP analysis is rather on liquidity units relating to comparable transaction types or contracts. An explicit reference should therefore be incorporated to the possibility of "contract type clustering".

Paragraph 62. GBIC Comment: Clarification

We suggest using known references in order to define "material" or "significant" currencies.

As to the monitoring of currencies, please clarify the term "material".

Paragraph 71. GBIC Comment: Clarification

This paragraph makes a distinction between (self-engineered) implemented risk quantification methodologies and vendor models without stating a clear definition of the different expectations.

In the case of vendor models, the expectations in terms of a "full understanding" should be less strict than for those for self-implemented models.

Paragraph 73. GBIC Comment: Amendment

In our view, an institution should be able to choose between different forms of separation of model development and validation, depending on the significance of individual models and according to the principles of proportionality.

The ILAAP Guide emphasises the principle of proportionality in the context of the independent validation function. With regard to the proportionate design of the independent validation, according to para. 73, the materiality and complexity of the risks and methods are decisive. Thus, in Example 6.1 as well, the organisational implementation is required according to the nature, size, scale and complexity of the risks. Accordingly, for Pillar 2 models, it should be possible to differentiate the independent validation according to the nature of the risk and its significance for the bank (i.e. the organisational forms described in Example 6.1 may vary depending on the materiality and complexity of the type of risk in a credit institution). However, the TRIM Guide also has to be taken into account here. In our view, however, it is necessary to make a distinction between Pillar 1 and 2 models with regard to the validation function in that the cost of recognition of Pillar 1 models is only worthwhile for material risks, and therefore specifically higher validation requirements should be set here. However, these should not be introduced for Pillar 2 models without reflection.

Paragraph 74. GBIC Comment: Amendment

The principle of proportionality should be ensured with regard to validation. Delete the reference to TRIM.

It does not make sense to have an undifferentiated connection between the design of the validation function and the size of an institution. In this respect, the reference to TRIM in Example 6.1. is not appropriate, for example because this rules out a proportionate design of the validation organisation solely on the basis of the G-SII or O-SII status and irrespective of the materiality and complexity of individual risk types. By contrast, according to para. 11, the ILAAP Guide is addressed exclusively to credit institutions that are significant supervised entities within the meaning of Article 2(16) of the SSM Framework Regulation. The reference to the TRIM Guide thus contradicts the proportionality emphasised in the ILAAP Guide. The reference to TRIM should therefore be deleted (particularly as a review of the requirements has already been announced in footnote 13 of the TRIM Guide).

Paragraph 75. GBIC Comment: Clarification

The principle of proportionality should be ensured with regard to validation.

Example 6.1 should use the phrase of paragraph 73 and hence be reworded as "…Depending on the nature, size, scale and ***materiality of the risks quantified, and the complexity of the risk quantification methodology***…