DG Internal Market and Services
Banking and Financial Conglomerates Unit
European Commission
SPA2 4/29
BE-1049 Brussels

16 April 2010

Dear Sirs,

Response submission from ICMA ECP Committee:

Re: European Commission Consultation Paper - "Possible Further Changes to the Capital Requirements Directive ('CRD IV')"

Introduction:

On behalf of the Euro Commercial Paper ("ECP") Committee of the International Capital Market Association ("ICMA"), the purpose of this letter is to provide feedback concerning certain specific aspects of the European Commission's 26 February 2010 consultation paper - "Possible Further Changes to the Capital Requirements Directive ('CRD IV')".

The ECP market is a professional short-term debt market which offers opportunities for issuers to raise working capital and other short-term funding as well as for institutional investors to make varied and reliable short-term investments. ICMA's ECP Committee represents the main dealers in the ECP market.

The ICMA ECP Committee notes that on 17 December consultative proposals to strengthen the resilience of the banking sector were announced by the Basel Committee on Banking Supervision. The Basel Committee's consultative documents cover the following key areas:

- Raising the quality, consistency and transparency of the capital base;
- Strengthening the risk coverage of the capital framework;
- Introducing a leverage ratio as a supplementary measure to the Basel II risk-based framework;
- Introducing a series of measures to promote the build-up of capital buffers in good times that can be drawn upon in periods of stress; and
- Introducing a global minimum liquidity standard for internationally active banks.

The ICMA ECP Committee is very pleased to note that the European Commission strongly supports the work of the Basel Committee in these areas; and that accordingly the possible changes set out in this European Commission consultation are closely aligned with the expected amendments to the Basel II framework and the introduction of a global liquidity standard.

Whilst there are many interesting issues discussed in these consultation papers, the ICMA ECP Committee is for now going to primarily restrict its focus to those aspects that bear most directly on ECP. As the ICMA ECP Committee sees it, the most pertinent section of the consultation papers is that regarding Liquidity.

Commentary on liquidity proposals:

There is much in this consultation paper with which the ICMA ECP Committee agrees, including that it is helpful to establish an internationally agreed standard covering liquidity risk. Nevertheless it is clear that these new liquidity risk standards will significantly impact funding.

Given the critical need for consistency between the international proposals under development in the Basel Committee and the European proposals under development by the European Commission you will find appended a copy of the ICMA ECP Committee's response to the Basel Committee's 17 December consultation. The ICMA ECP Committee respectfully requests the European Commission to consider the substance of this in its finalised proposals, the development of which should continue to progress in tandem with the Basel proposals.

As you will observe, the key point of the ICMA ECP Committee's response is to convey its belief that the characteristics of ECP are such that ECP represents an asset of appropriate quality for recognition as a liquid asset eligible for inclusion in the contemplated "broader definition".

Should you have any questions, please contact David Hiscock in the first instance.

Yours faithfully,

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CC : ICMA ECP Committee

Appendix

Bank for International Settlements
CH-4002 Basel
Switzerland

16 April 2010

Dear Sirs,

Response submission from ICMA ECP Committee:

Re: Basel Committee Consultation Paper - "International framework for liquidity risk measurement, standards and monitoring"

Introduction:

On behalf of the Euro Commercial Paper ("ECP") Committee of the International Capital Market Association ("ICMA"), the purpose of this letter is to provide feedback concerning certain specific aspects of the Basel Committee on Banking Supervision's 17 December 2009 consultation paper - "International framework for liquidity risk measurement, standards and monitoring".

The ECP market is a professional short-term debt market which offers opportunities for issuers to raise working capital and other short-term funding as well as for institutional investors to make varied and reliable short-term investments. ICMA's ECP Committee represents the main dealers in the ECP market.

The ICMA ECP Committee notes that on 17 December consultative proposals to strengthen the resilience of the banking sector were announced by the Basel Committee. The Basel Committee's consultative documents cover the following key areas:

- Raising the quality, consistency and transparency of the capital base;
- Strengthening the risk coverage of the capital framework;
- Introducing a leverage ratio as a supplementary measure to the Basel II risk-based framework;
- Introducing a series of measures to promote the build-up of capital buffers in good times that can be drawn upon in periods of stress; and
- Introducing a global minimum liquidity standard for internationally active banks.

The Basel Committee is also reviewing the need for additional capital, liquidity or other supervisory measures to reduce the externalities created by systemically important institutions. Impact assessment will be carried out in the first half of 2010. On the basis of this assessment, the Basel Committee will then review the regulatory minimum level of capital and the reforms proposed in this document to arrive at an appropriately calibrated total level and quality of capital. The fully calibrated set of standards will be developed by the end of 2010 to be phased in as financial conditions improve and the economic recovery is assured, with the aim of implementation by end-2012.

Whilst there are many interesting issues discussed in these Basel Committee consultation papers, the ICMA ECP Committee is for now going to primarily restrict its focus to those aspects that bear most directly on ECP. As the ICMA ECP Committee sees it, the most pertinent section of the consultation papers is that regarding Liquidity.

Commentary on liquidity proposals:

The annex to this response provides a very brief outline of those key aspects of the liquidity proposals which have attracted the ICMA ECP Committee's particular attention. As a general remark, the goal to come to a more harmonised liquidity regulation can only be encouraged. Further, it is clear that these new liquidity risk standards will significantly impact funding. Much more emphasis is being placed on deposits & long-term funding, which are seen as "stable".

A key question relates to the definition of liquidity. Far greater demands to hold high quality liquid assets as a buffer will arise and, in practice, Government securities will form the basis of bank liquidity buffers. Assets that are not considered highly liquid will attract increased costs as they cannot be counted in the liquidity reporting and longer term funding needs to be set against holding them. Given this overall context the ICMA ECP Committee believes that ECP should be considered as a liquid asset eligible for inclusion in the contemplated "broader category". In support of this proposition the ICMA ECP Committee draws the Basel Committee's attention to the following points:

- ECP is the largest and most liquid CP market in Europe, with outstandings of over €435 bn, daily volumes averaging €10 bn, and over 350 active issuers;
- Maturities are very short: about 47% of outstandings mature in one month or less, while 83% mature in three months or less
  - Principal realised in short order; and
  - Very low price volatility;
- Transparency
  - For market access and up to the minute pricing information, investors can use TradeWeb and Bloomberg's ECPX. These applications allow access to offerings across the spectrum of issuers, maturities and currencies from a full range of dealers. On average, TradeWeb has displayed over 5,000 postings per day;
  - Outstandings, volume, and pricing data are readily obtainable
    - Euroclear publishes monthly outstandings and volume data by currency on its open website;
    - Further data can be obtained by subscribing to or working with dealer subscribers of CPWare or Capital Markets Daily (CMD). Unlike in other markets, users of CPWare/CMD can access and search and sort data real time on a trade-by-trade basis;
    - Reuters has recently introduced a Tradeweb function "TWEBECP" which allows a Reuters user to look at up to date pricing across the market by currency; issuer type; maturity, as a yield or spread to the relevant curve; and
    - Euroclear Bank publishes "Euroclear ECP Indices", a free online application that displays weighted average yields for Euro Commercial Paper. Investors and issuers have access to daily and weekly computed ECP yield data sourced from a neutral service provider. The Euroclear ECP Indices enable market participants to benchmark their trading activity not just against Euribor and LIBOR, but against the broad ECP market as well;

- Strong, safe documentation framework
  - ECP has offered a pan-European documentation model for more than twenty years. There have been no scandals or accusations of improper ECP dealing since market inception in the mid-eighties;
  - ECP was exempted from the Prospectus Directive (as was all debt with an original maturity of under 365 days), following scrutiny by the European Commission, European Parliament and CESR; and
  - The information memorandum is the disclosure document prepared by the issuer and its counsel and is reviewed by the dealers on the programme; and
- Some ECP issuance is listed and eligible as central bank collateral with the ECB and some is also eligible at the BoE. We recognise that central bank collateral frameworks are independent from the liquidity regime that is proposed in this consultation, but nevertheless the asset quality criteria that are applied in these contexts are illustrative of the quality of the underlying ECP market.
- Over 30% of the ECP market is issued by sovereign, supranational or quasi sovereign issuers, which has been an increased focus since the outset of the crisis. This shows that the ECP market indeed acts as a facilitator for "flight to quality" trades.
- ECP dealers are well capitalised and highly regulated banks and securities firms.

Summary:

There is much in this consultation paper with which the ICMA ECP Committee agrees, including that it is helpful to establish an internationally agreed standard covering liquidity risk.

The ICMA ECP Committee believes that the characteristics of ECP are such that ECP represents an asset of appropriate quality for recognition as a liquid asset eligible for inclusion in the contemplated “broader category”; and respectfully requests the Basel Committee to recognise this in its finalised proposals.

Should you have any questions, please contact David Hiscock in the first instance.

Yours faithfully,

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CC : ICMA ECP Committee

Annex:

Summary of key points re liquidity ratios noted from the Basel text

In the consultative proposals, two separate but complementary liquidity risk standards are advanced[1]:

(i) the Liquidity Coverage Ratio; and

(ii) the Net Stable Funding Ratio (NSF).

The scenario proposed for this standard entails a combined idiosyncratic and market-wide shock which would result in (inter alia):

- Loss of unsecured wholesale funding capacity and reductions of potential sources of secured funding on a term basis;
- Loss of funding on asset-backed commercial paper, conduits, securities investment vehicles and other such financing facilities; and
- Unscheduled draws on all of the institution's committed but unused credit.

Conversely in considering inflows:

- It is assumed banks will receive 100% of all performing contractual wholesale cash inflows; and
- No lines of credit, liquidity facilities or other contingent funding facilities that the bank holds at other institutions for its own purposes are assumed to be able to be drawn.

The numerator of the LCR is the "stock of high quality liquid assets". Under the proposed standard, banks must hold a stock of unencumbered, high quality liquid assets which is clearly sufficient to cover cumulative net cash outflows (as defined below) over a 30-day period under the prescribed stress scenario. In order to qualify as a "high-quality liquid asset", assets should be liquid in markets during a time of stress and, ideally, be central bank eligible. The Basel Committee consultation calls for assessment of "both a narrow definition of liquid assets comprised of cash, central bank reserves and high quality sovereign paper, as well as a somewhat broader definition which could also include a proportion of high quality corporate bonds and/or covered bonds".

Characteristics of high quality liquid assets:

Assets are considered to be high quality liquid assets if they can be easily and immediately converted into cash at little or no loss of value. The test of the "high quality" of assets is that by way of sale or secured borrowing, their liquidity-generating capacity is assumed to remain intact even in periods of severe idiosyncratic and market stress. An attempt by a bank to raise liquidity from lower quality assets under conditions of severe market stress would entail acceptance of a large fire-sale discount or haircut to compensate for high market risk.

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[1] On a related matter, it is noted that on 9 December the Committee of European Banking Supervisors (CEBS) published new guidelines on liquidity buffers and survival periods. These CEBS guidelines, intended for application by 30 June, consider applying stress scenarios, considering at least a one month survival period and one week requirements, in determining adequate liquidity buffers – to be comprised of cash and core assets that are both central bank eligible and highly liquid in private markets.

- Fundamental characteristics
  - Low credit and market risk: assets which are less risky tend to have higher liquidity. On the credit risk front, high credit standing of the issuer and a low degree of subordination increases an asset's liquidity. On the market risk front, low duration, low volatility, low inflation risk and being denominated in a convertible currency with low foreign exchange rate risk all enhance an asset's liquidity;
  - Ease and certainty of valuation: an asset's liquidity increases if market participants are more likely to agree on its valuation. A liquid asset's pricing formula must be easy to calculate and not depend on strong assumptions. The inputs into those pricing formula must also be publicly available. In practice this should rule out the inclusion of any exotic product.
  - Low correlation with risky assets: the stock of high quality liquid assets should not be subject to wrong-way risk. Assets issued by financial firms, for instance, are more likely to be illiquid in times of liquidity stress in the banking sector.
  - Listed on a developed and recognised exchange market: being listed increases an asset's transparency.
- Market-related characteristics
  - Active and sizable market: the asset should have active outright sale and repo markets at all times (which means having a large number of market participants and a high trading volume). Market breadth (price impact per unit of liquidity) and market depth (units of the asset can be traded for a given price impact) should be good.
  - Presence of committed market makers: quotes will always be available for buying nd/or selling the asset.
  - Low market concentration: diverse group of buyers and sellers in an asset's market increases the reliability of its liquidity.
  - Flight to quality: historically, the market has shown tendencies to move into some types of assets in a systemic crisis.

The stock of high quality liquid assets should be comprised of assets which meet the characteristics outlined above. The following list describes the assets which meet these characteristics and can therefore be used as the stock of liquid assets:

(a) cash;

(b) central bank reserves, to the extent that they can be drawn down in times of stress

(c) Marketable securities representing claims on or guaranteed by sovereigns, central banks, non-central government public sector entities, the BIS, the IMF, the European Commission, or MDBs – as long as all the following criteria are met:
   (i) they are assigned a 0% risk-weight under the Basel II standardised approach; and
   (ii) deep repo-markets exist for these securities; and
   (iii) the securities are not issued by banks or other financial services entities.

(d) government or central bank debt issued in domestic currencies by the country in which the liquidity risk is being taken or the bank's home country.

In addition, the Basel Committee will gather data on the following instruments – if included in the stock of liquid assets, these instruments would receive substantial haircuts, would comprise not more than 50% of the overall stock, and the portfolio would have to be diversified.

Corporate and covered bonds that satisfy all of the following conditions:

- Central bank eligibility;
- Not issued by a bank, investment or insurance firm;
- Low credit risk;
- Traded in large, deep and active markets; and
- Proven record as a reliable source of liquidity in the markets (repo and sale) even during stressed market conditions.

These assets must be unencumbered and freely available to the relevant group entities and should be managed with the clear and sole intent for use as a source of contingent funds. A bank should periodically monetise a proportion of the assets in its liquid assets buffer through repo or outright sale to the market in order to test the usability of the assets. Banks are expected to be able to meet their liquidity needs in each currency and maintain high quality liquid assets consistent with the distribution of their liquidity needs by currency.