BANQUE CENTRALE DU LUXEMBOURG
EUROSYSTÈME

cssf

Impact assessment of the new liquidity rules on Luxembourg banks

1 Context

Following a first study in Q1/2011, a second local Quantitative Impact Study (QIS) of the new liquidity standards for credit institutions, based on the version published by the Basel Committee on Banking Supervision (BCBS) in December 2010[1], was conducted in Q2/2011 jointly by the BCL and the CSSF.

2 Objectives

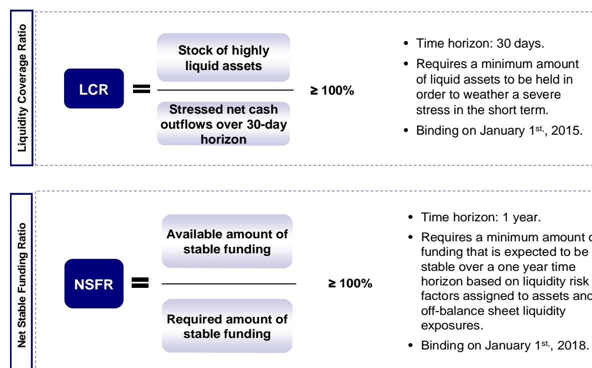
The main objectives were:

- Assessing the impact of the new liquidity standards on Luxembourg banks;
- Identifying any unintended consequences, which could result from the introduction of the liquidity standards at local level;
- Raising awareness of the new liquidity standards among the Luxembourg banking community at an early stage of the observation period; and
- Providing input to Luxembourg authorities' position in international discussions.

3 Definition

The local QIS is based on the two new liquidity standards developed by the BCBS, the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR). The current study did not yet take into account the proposal of the European Commission on the capital requirement directive (CRD IV), which was published on 20 July 2011.

Figure 1 - Short description of the two ratios



[1] International Framework for Liquidity Risk Measurement, Standards and Monitoring; http://www.bis.org/publ/bcbs188.htm

4 Quantitative Impact Study results

***DISCLAIMER**: Data collection was mainly based on the production of ad hoc figures delivered by participating banks and this, under the assumption that banks maintain their current business model and taking into account some individual interpretation given by the preliminary status of the underlying regulation.*

4.1 Survey outline

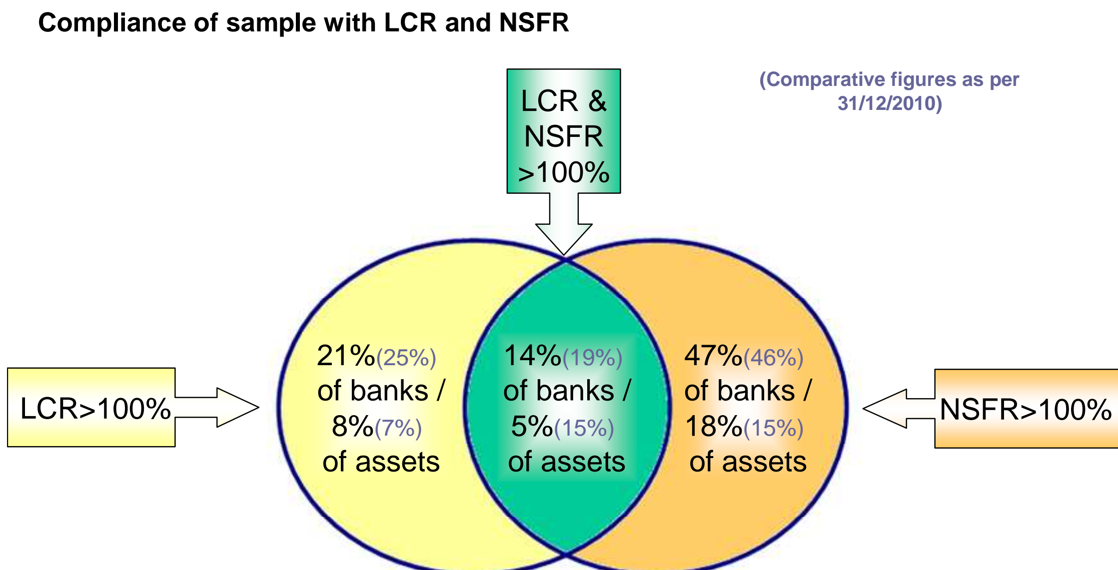
The survey was based on data as per 30/06/2011 and the sample of banks chosen was the same as for the survey performed as per 31/12/2010 data. This sample is deemed to be representative of the local financial sector in terms of total assets, number of banks, business models and sizes of the banks surveyed.

In total 59 banks (40% of total banks) participated in the survey, representing EUR 606 bn in assets (80% of the total assets of the banking sector). Total assets represented in the sample of banks remained quite stable compared to the previous impact study.

4.2 Overall results

The number of banks complying with the LCR and NSFR ratios remains small. Only 8 banks out of 59 fulfill both of the new liquidity ratios, representing a decrease compared to the results of the first impact study on December 2010 data in which 11 banks out of 59 fulfilled both ratios.

Figure 2 - Compliance of sample with LCR and NSFR requirements

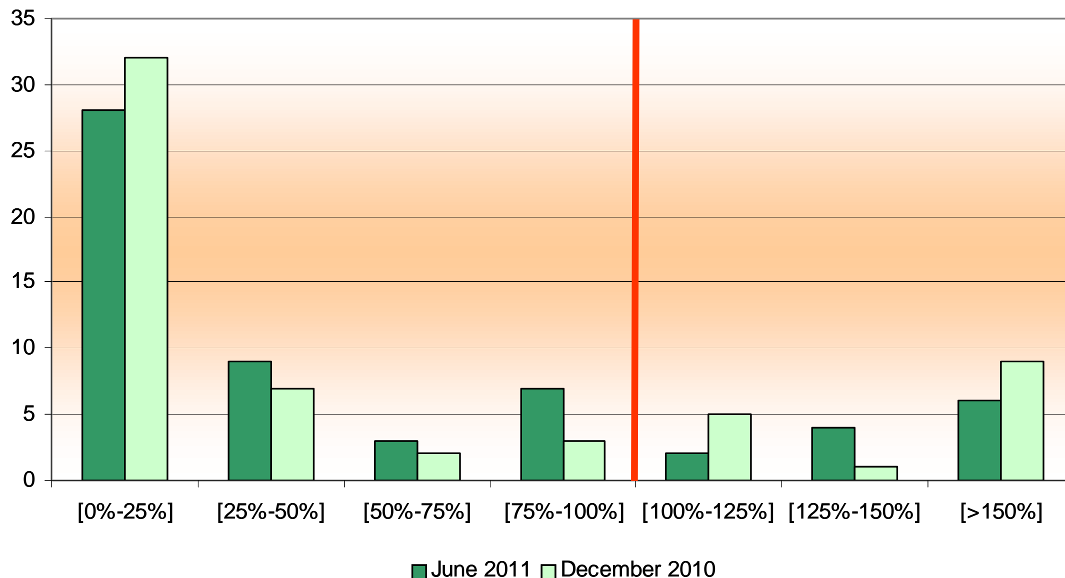


For the same sample of banks, compliance with LCR requirements decreased compared to the previous impact study based on December 2010 data, where 25% of participating banks fulfilled LCR requirements. Compliance with NSFR requirements remained stable throughout both impact studies with 47% respectively 46% of participating banks fulfilling NSFR requirements.

4.2.1 LCR results

The results show that 12 banks out of the sample of 59 banks would comply with the LCR compared to 15 banks on December 2010. The distribution of these results shows that the banks fulfill the LCR either comfortably or not at all. Due to the deterioration of market conditions during the first half of 2011, banks that barely fulfilled the LCR requirements as at December 2010 came up short of being compliant with the LCR in June 2011.

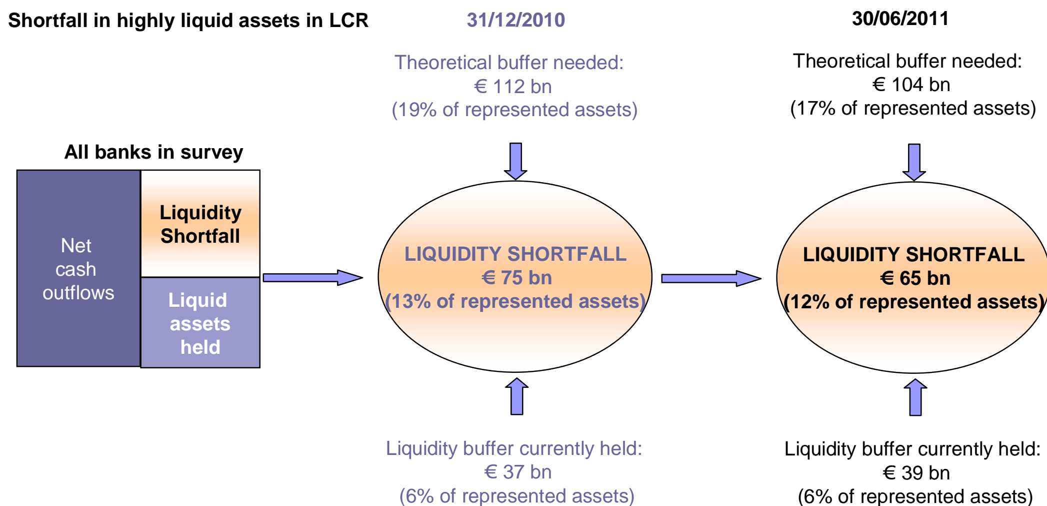
Figure 3 - Distribution LCR



In terms of number of banks, compared to the previous impact study with December 2010 data, 5 banks fulfilling LCR as at December 2010 didn't fulfill LCR requirements as at June 2011 mainly due to an increase of the outflows with a parallel reduction of their buffer. On the other hand 2 banks not fulfilling the LCR as at December 2010 fulfilled LCR requirements as at June 2011.

According to these results, the banks surveyed would face a potential aggregated shortfall of EUR 65 bn in highly liquid assets in order to comply with the LCR compared to a EUR 75 bn aggregate shortfall in December 2010 (assuming no adjustments in their business model).

Figure 4 - Shortfall in highly liquid assets



On the other hand, the average LCR ratio for the banks in the sample decreased from 59% as at December 2010 to 55% as at June 2011.

The decrease of the shortfall is due to the combined effect of an increase in the buffer of liquid assets on the one hand and a decrease in the theoretical buffer needed for the whole sample on the other hand. This positive evolution is however mainly driven by two banks that have reduced their total net cash outflows by about EUR 7.616 Mio and increased their buffer of liquid assets by EUR 3.454 Mio. This explains why, while the aggregated shortfall has decreased, on average the compliance with the LCR has slightly decreased compared to the first survey. This evolution may be explained by the following facts:

- The majority of banks have not yet adjusted their business models;
- The deterioration of market conditions, especially with regards to sovereigns, has decreased the value of eligible assets for the liquidity buffer[2];
- Some banks have decreased their position towards sovereigns from PIIGS countries.

Given that market pressure on sovereigns has further increased during the second half of 2011, it is to be expected that without changes to the business model or business activities the average compliance with the LCR will not materially improve in the near future.

[2] This is the case for 32 banks in the sample

In terms of size, it has to be noted that small banks[3] exhibit a smaller shortfall and tend to operate with stocks of liquid assets closer to the LCR requirements than medium[4]- and large-sized banks[5]. In terms of business model, the universal and private banks show a more significant shortfall than the other banks as for international active banks liquidity buffers are often held outside the Luxembourg entity. These observations remain in line with those made during the previous impact study.

Figure 5 - Stock of highly liquid assets by size

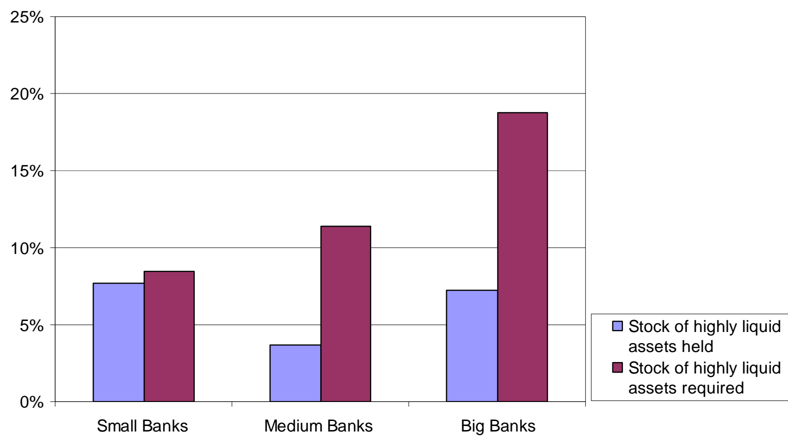
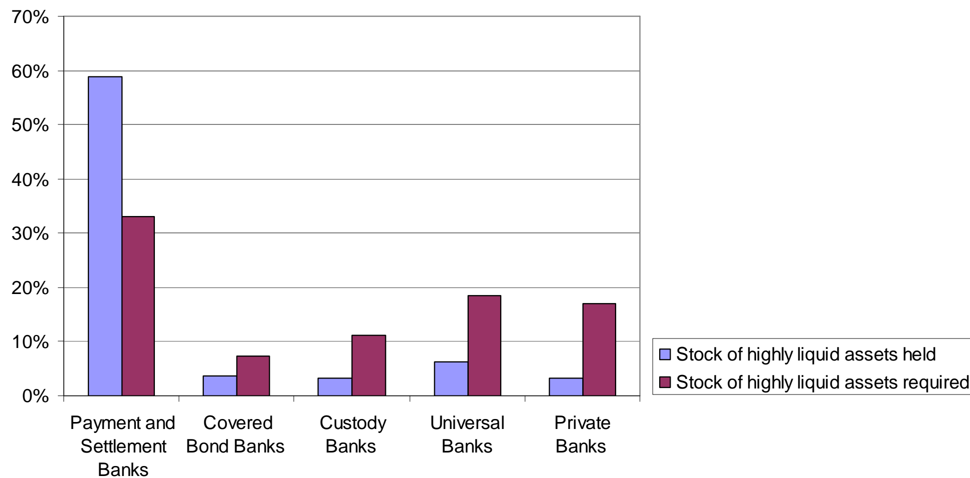


Figure 6 - Stock of highly liquid assets by business model



Regarding the main drivers behind the liquidity requirements set out in the LCR, the composition of the in- and outflows is key. In this respect, the most important element remains the unsecured wholesale funding without operational relationship, representing

[3] total assets < EUR 1 bn
[4] total assets > EUR 1 bn and < EUR 10 bn
[5] total assets > EUR 10 bn

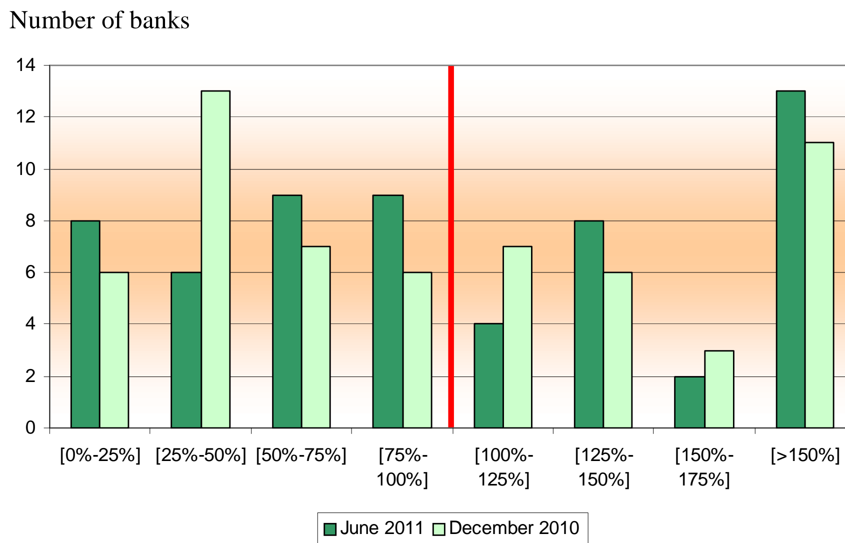
75% of the total aggregated outflows. Short-term intra-group funding represents a major part of the latter.
The same composition can be observed for the aggregated inflow categories which mirror, in general, the outflow composition.

Compared to the previous impact study the composition of outflows and inflows has not changed fundamentally.

4.2.2 NSFR results

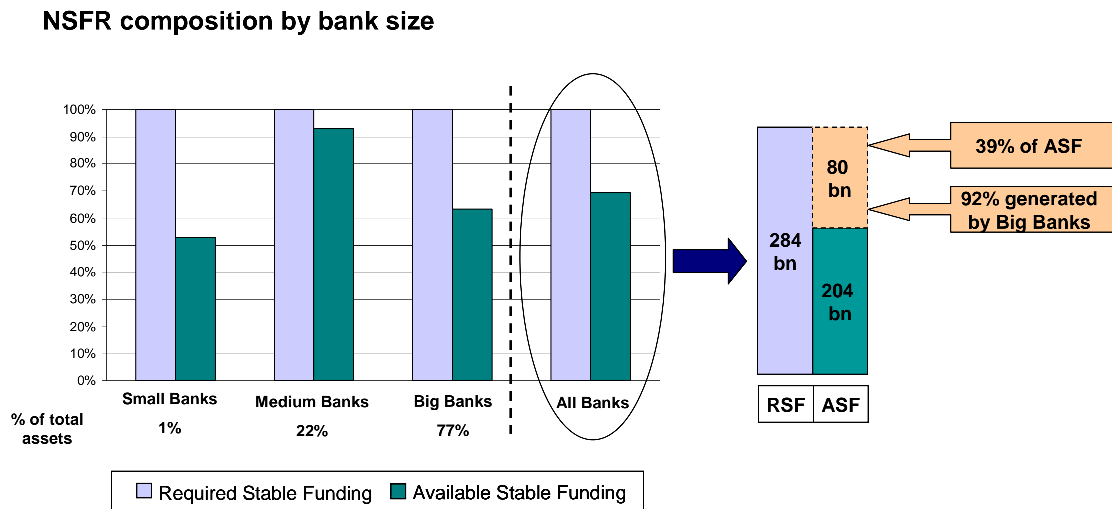
The QIS results reveal that 27 banks out of the sample of 59 banks would comply with the NSFR. In line with the previous impact study, the distribution of these results is more balanced than the distribution of the LCR ratio.

Figure 7 - Distribution NSFR



The aggregated required stable funding would amount to EUR 284 bn whereas the aggregated available stable funding would represent EUR 204 bn. This would result in a shortfall of EUR 80 bn, which represents 39% of the total available stable funding presently held by the banks at end of June 2011.

Figure 8 - NSFR composition by bank size



5 Next steps

During 2012 CSSF and BCL will continue to monitor regularly the evolution and the impact of the new liquidity ratios on the local banking sector. It is planned to request data on a quarterly basis from those banks that have already participated in the two impact studies. All other credit institutions are invited to participate and to submit their respective data on a voluntary basis.

Regular reporting on an at least quarterly basis of the new ratios to the supervisory authorities will be based on harmonized standards currently developed by the European Banking Authority and will start officially by January 1st, 2013. After a transition period the new ratios are expected to be binding as from January 1st, 2015 for the LCR and probably January 1st, 2018 for the NSFR, within the scope of application and following the operational details foreseen in the current Capital Requirements Directive (CRD IV) proposal of the EU-Commission (July 20, 2011).