BANQUE CENTRALE DU LUXEMBOURG
EUROSYSTÈME

CSSF

Impact assessment of the new liquidity rules on Luxembourg banks

Abstract of the presentation held at the ABBL conference "Basel III – New Liquidity Rules: Which Impacts for Luxembourg?"

1 Context

A local Quantitative Impact Study (QIS) of the new liquidity standards, published by the Basel Committee on Banking Supervision (BCBS) in December 2010[1], was conducted in Q1/2011 jointly by the BCL and the CSSF.

2 Objectives

Main objectives:

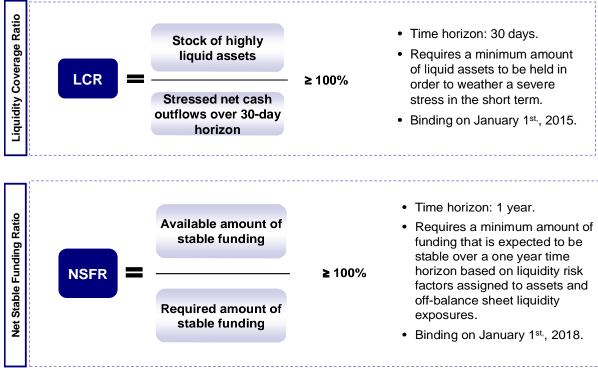
- Assessing the impact of the new liquidity standards on Luxembourg banks;
- Identifying any unintended consequences, which could result from the introduction of the liquidity standards at local level; and
- Raising awareness of the new liquidity standards among the Luxembourg banking community at an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

Another important role of this QIS was to support and back up the Luxembourg authorities' attitude in international discussions within the Basel Committee, the European Banking Authority and at the EU.

3 Definition

The local QIS is based exclusively on the two new liquidity standards developed by the BCBS, the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR). This study does not take into account any upcoming European regulation.

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

4.1 Survey outline

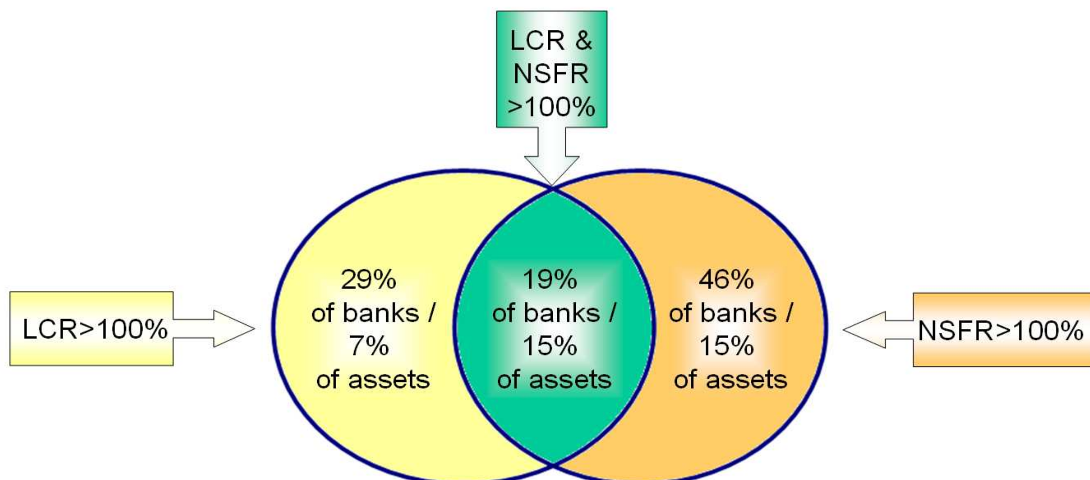
***DISCLAIMER**: Data collection was mainly based on the production of ad hoc figures delivered by participating banks and this, under the assumption that banks maintain their current business model and taking into account some individual interpretation given by the preliminary status of the underlying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

The survey was based on data as per 31/12/2010 and the sample of banks was chosen to be representative of the financial sector in terms of total assets, number of banks, business models and size of the banks surveyed. In total 59 banks (40% of total banks) participated in this survey representing EUR 591bn in assets (77% of the total assets).

4.2 Overall results

The number of banks complying with the LCR and NSFR ratios is relatively limited. Only 11 banks out of 59 fulfill both of the new liquidity ratios.

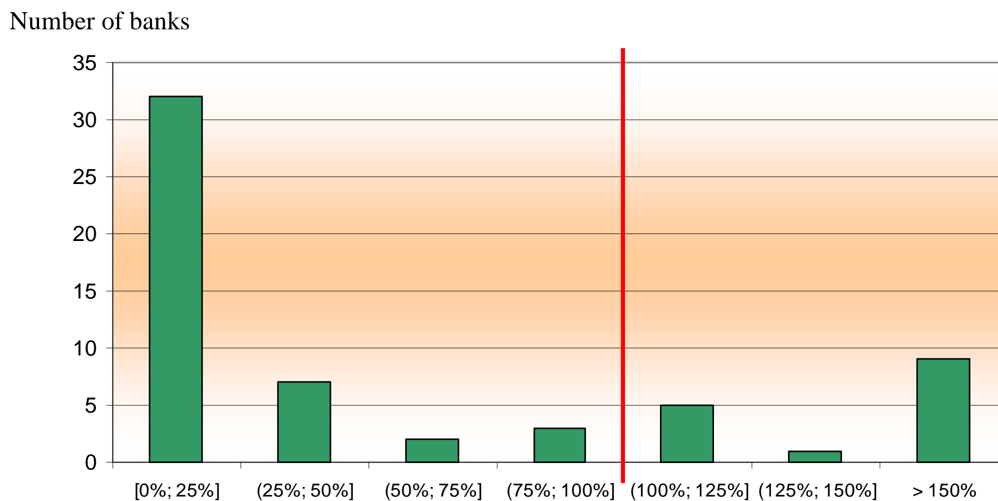
Figure 2 - Compliance of sample with LCR and NSFR requirements



4.3 LCR results

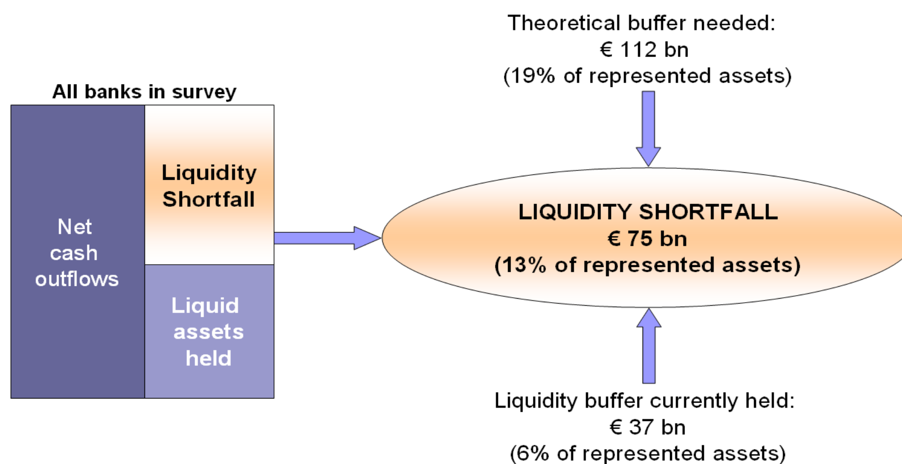
The QIS results reveal that 15 banks out of the sample of 59 banks would comply with the LCR. The distribution of these results shows that the banks fulfill the LCR either comfortably or not at all.

Figure 3 - Distribution LCR



According to these results, the banks surveyed would face a potential aggregated shortfall of EUR 75 bn in highly liquid assets in order to comply with an LCR requirement.

Figure 4 - Shortfall in highly liquid assets



In terms of size, it is noteworthy that small banks[2] exhibit a smaller shortfall and tend to operate with stocks of highly liquid assets closer to the LCR requirements than medium[3] and large banks[4]. In terms of business model, the universal and private banks exhibit a higher shortfall than the other banks.

Figure 5 - Stock of highly liquid assets by size

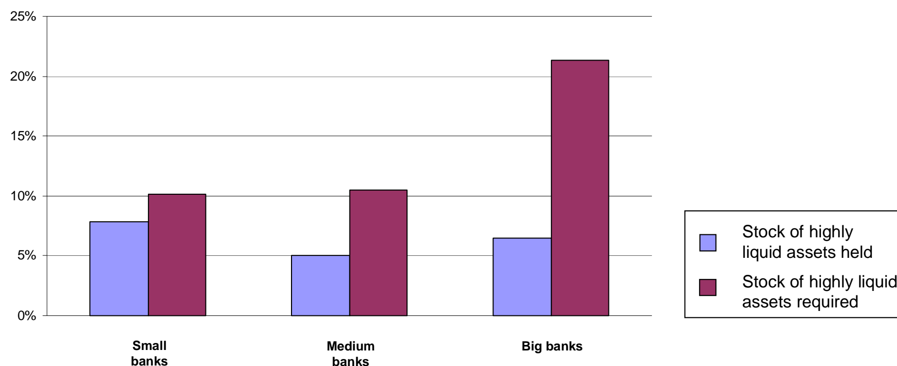
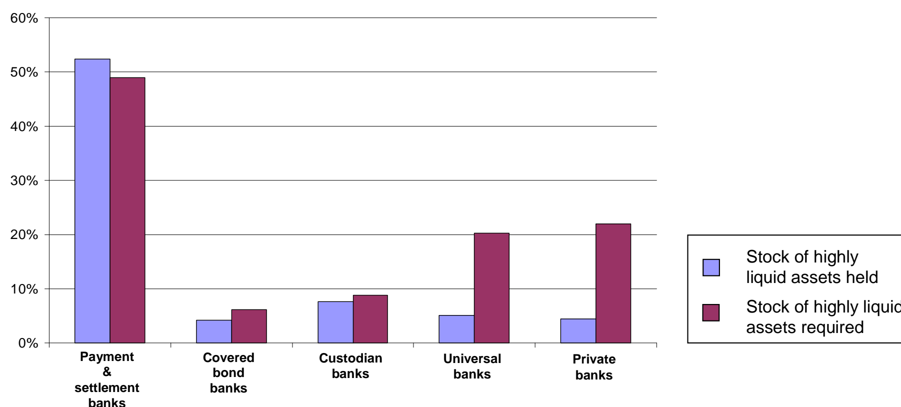


Figure 6 - Stock of highly liquid assets by business model



Regarding the main drivers behind the liquidity requirements given by the LCR, the composition of the outflows and inflows are key. In this respect, the most important element is the unsecured wholesale funding without operational relationship which represents 73% of the total aggregated outflows. The short-term intra-group funding represents the most significant part of this element (44%).

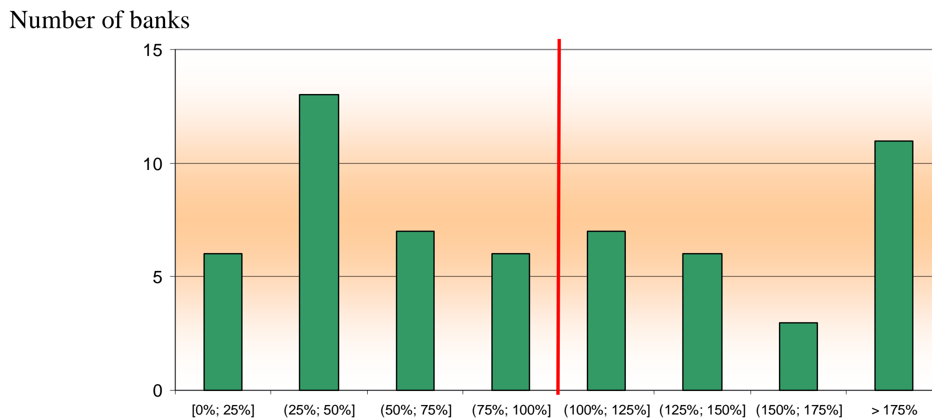
The same composition can be observed for the aggregated inflow categories which mirror, in general, the outflow composition. The intra-group activities account for 65% of the total aggregated inflows.

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

4.4 NSFR results

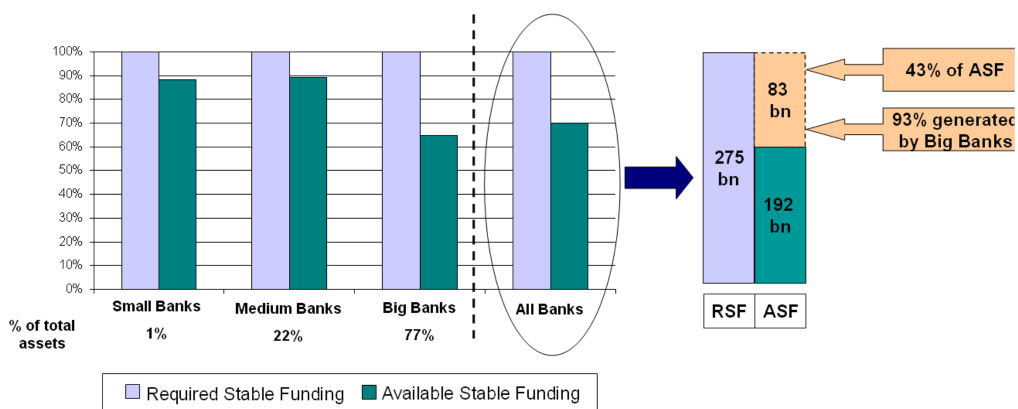
The QIS results reveal that 27 banks out of the sample of 59 banks would comply with the NSFR. The distribution of these results is more balanced than the distribution of the LCR.

Figure 7 - Distribution NSFR



The aggregated required stable funding would amount to EUR 275 bn whereas the aggregated available stable funding would represent EUR 192 bn. This would result in a shortfall of EUR 83 bn, which represents 43% of the total available stable funding held to date by the banks.

Figure 8 - NSFR composition by bank size



5 Conclusions and potential implications

Currently only a low number of banks would fulfill the LCR and NSFR ratios. However this is not necessarily a reflection of a poor liquidity situation of Luxembourg banks.

Luxembourg banks are mainly subsidiaries of foreign banking groups pursuing less diversified business activities and having high percentages of intra-group funding and intra-group exposures, which are considered as cash positions from third party financial corporate customers within the ratios and do not offer any “advantage” in this new approach. Furthermore, due to a 75% cap constraint on cash inflows in relation to total outflows, “fully matched cash in- and out-flows” are not anymore sufficient to fulfill the new liquidity requirements. A minimum level of highly liquid assets will be needed at all times. The inflow cap currently applies to 43% of the participating banks and only a limited number of these (29% of the sample) thereafter still fulfill LCR requirements. In absence of this cap, 59% of participating banks would comply with LCR requirements.

Private banking business appears to be most affected by the introduction of the LCR. This result is partially explained by different counterparty structures used for wealthy private clients (corporate, fund structures…), whose deposits do not benefit from the more beneficial treatment of retail or SME client deposits.

The universal bank model was meant to be encouraged by the implementation of the new ratios as compared to an investment banking model. However the outcome observed in Luxembourg could suggest that the ratio might be less favorable to them. This might however be mitigated by the fact that these banks generally tend to fall in the category of banks historically matching cash in- and out-flows rather than holding a stock of liquid assets.

Custodian banks seem to have the least difficulties in meeting the new liquidity requirements, but a clear separation of unsecured wholesale funding with operational relationship (benefiting from a more beneficial treatment) is required in the future.

6 Next steps

Further impact studies on the new liquidity ratios are planned or currently underway.

On an international level, the Basel Committee is conducting a Quantitative Impact Study based on data as per 31/12/2010; on a local level a follow-up Quantitative Impact Study will be conducted in Q3 by BCL and CSSF based on data as per 30/06/2011.

Regular reporting of the new ratios to the supervisory authorities will start as well as per January 1st, 2012. This does however not mean that banks will have to be fully compliant with the new standards as of this date. A transition period is foreseen and full compliance is expected as from January 1st, 2015 for the LCR and January 1st, 2018 for the NSFR.