MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Circular to Credit Institutions on the Delegated Act on Liquidity

Subsequent to the circular issued on 7th November 2014 on the postponement of the coming into force of the Liquidity Coverage Ratio (LCR), the Malta Financial Services Authority (MFSA) would like to draw the attention of all credit institutions licensed under the Banking Act 1994 or branches of EU credit institutions of the requirements of the Delegated Act on Liquidity[1] (DA) which specifies the detailed general liquidity coverage requirement (LCR) for credit institutions.

The need for more stringent liquidity rules is recognised at global level and standards to this end were included in the so-called Basel III-framework, developed by the Basel Committee. As a result of this, the Liquidity Coverage Requirement represents one of the most significant innovations of the CRR when compared to the preceding E.U. Directives on capital requirements. The aim of the LCR is to make credit institutions less dependent on short-term financing and central bank liquidity provision by requiring them to hold sufficient liquid assets (i.e. assets which can be liquidated at little or no loss of value) to withstand the excess of liquidity outflows over inflows that could be expected to accumulate over a 30 day stressed period.

Through the DA, the Commission requires a progressive rate of application of the LCR, rising from 60% (as from 1st October 2015) to reach 100% on 1st January 2018. When compared to the Basel III framework, the Commission proposes a number of adjustments to the LCR to reflect Union specificities, most notably for certain covered bonds and securitised assets.

The DA gives a rather extensive recognition for covered bonds, in the LCR since empirical analysis by the EBA has indicated their "excellent liquidity performance". Nonetheless, to avoid the LCR becoming overly dependent on this type of instrument, recognition is made subject to a number of caps and haircuts.

The DA allows the inclusion of other types of securitised assets which have performed well during the crisis, such as auto-loan ABS, in addition to residential mortgage-backed securities (RMBSs). The Commission believes that the inclusion of these instruments is compatible with the over-arching prudential objective of the LCR while avoiding the unintended consequences that non-recognition would have.

Article 23 of the DA[2] requires credit institutions to assess the extent of liquidity outflows during a 30 calendar day for products or services being provided by the institution but which are not covered by other articles in the Act or regulation. These outflows shall be assessed under the assumption of a combined idiosyncratic and market-wide stress. In terms of the said article, credit institutions are required to report on an annual basis such products and/or services for which the likelihood and potential volume of liquidity outflows is considered material.

The requirements of the DA will apply as from 1 October 2015.

Malta Financial Services Authority
26 November 2014

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[1] http://ec.europa.eu/internal_market/bank/docs/regcapital/acts/delegated/141010_delegated-act-liquidity-coverage_en.pdf#141010-liquidity

[2] Article 23 of the Delegated Act reflects the requirements laid down in CRR Article 420.