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Consulting Group

LIQUIDITY PROFILE OF EURO AREA BANKS

Assessing liquidity risk endurance through regulatory indicators

Featuring

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Table of contents

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Introduction

Research question
Estimate the liquidity profile of euro area large banks using regulatory indicators

Period
Jan 2018 - Dec 2022

LCR
Proportion of highly liquid assets held by financial institutions, to ensure their ongoing ability to meet short-term obligations
Regulation: LCR > 100% (from 2018)

NSFR
Proportion of long term assets funded by stable funding and is calculated as the amount of Available Stable Funding (ASF) divided by the amount of Required Stable Funding (RSF) over a one-year horizon.
Regulation: NSFR > 100% (from 2018)

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Data

Sources

Bankscope along with SDW

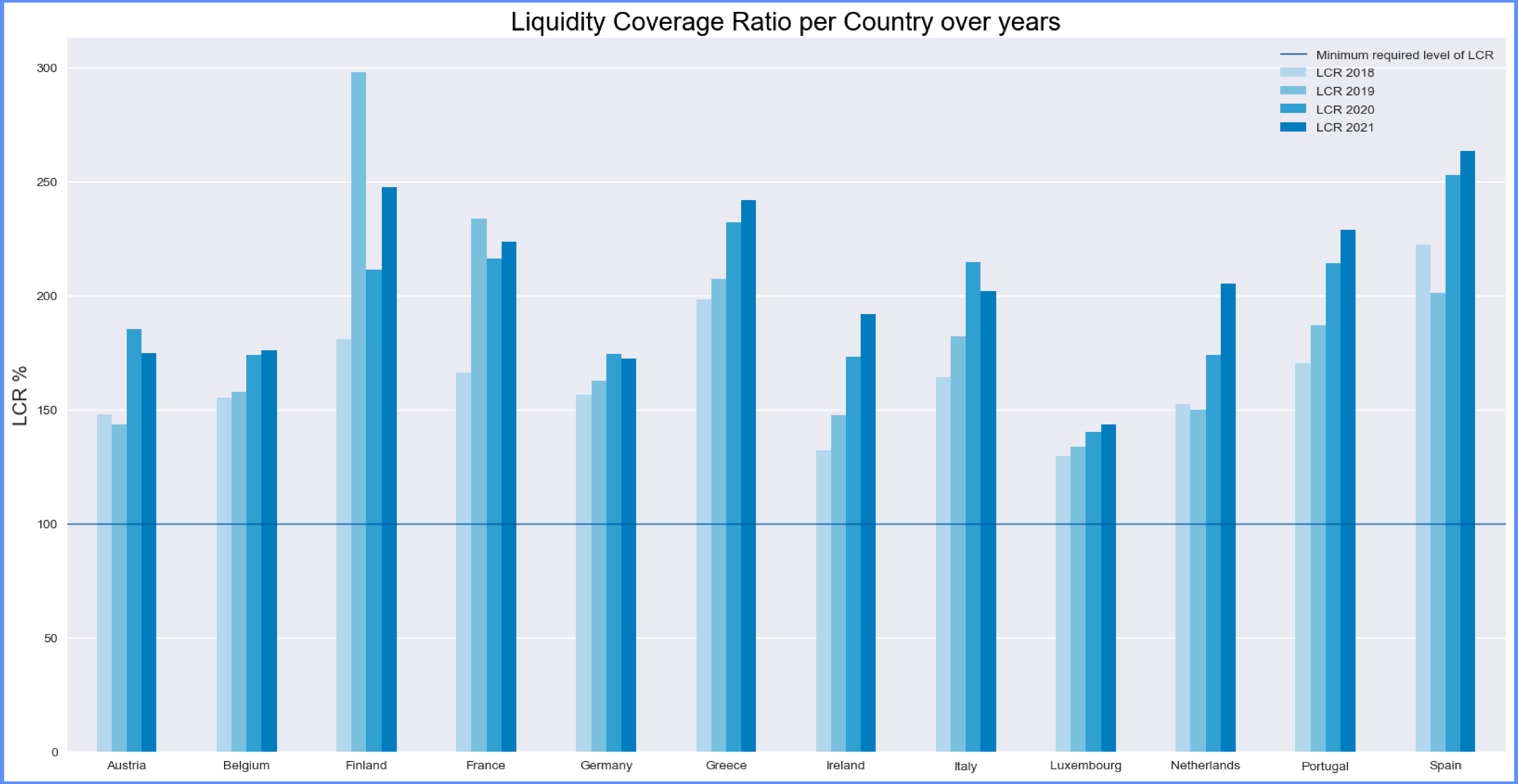
DATA

- one dataset 81 x 18 containing the NSFR per entity
- one dataset 33 x 18 containing the LCR per entity
- one dataset 33 x 25 which is the merge between the first two
- one dataset 16 x 8 containing quarterly data of the mean LCR per country
- one dataset containing 10y bond daily yields (for AAA and average of all ratings)

Filters

Total assets > 30 billion (significative institutions)

Liquidity Coverage Ratio analysis



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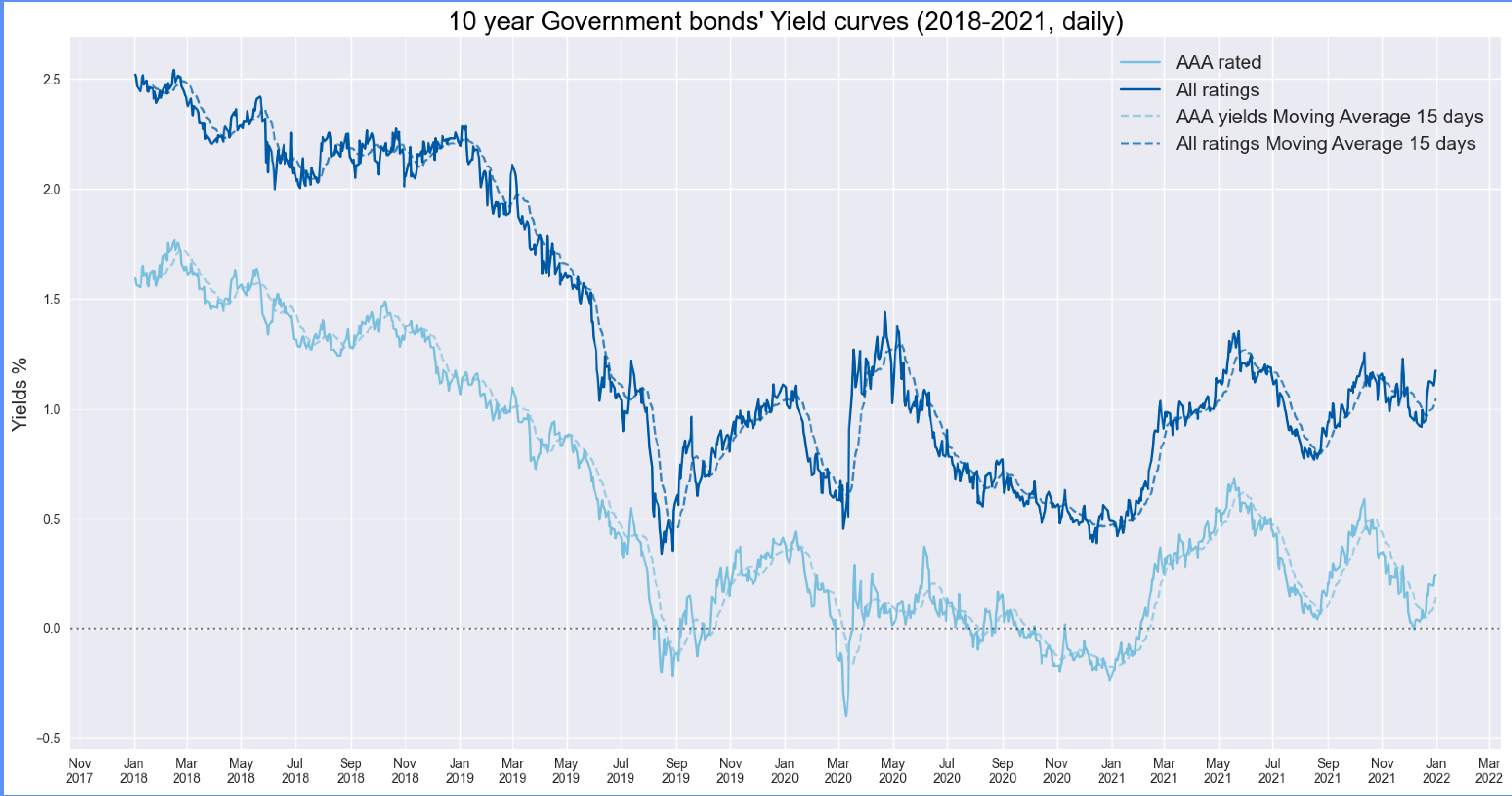
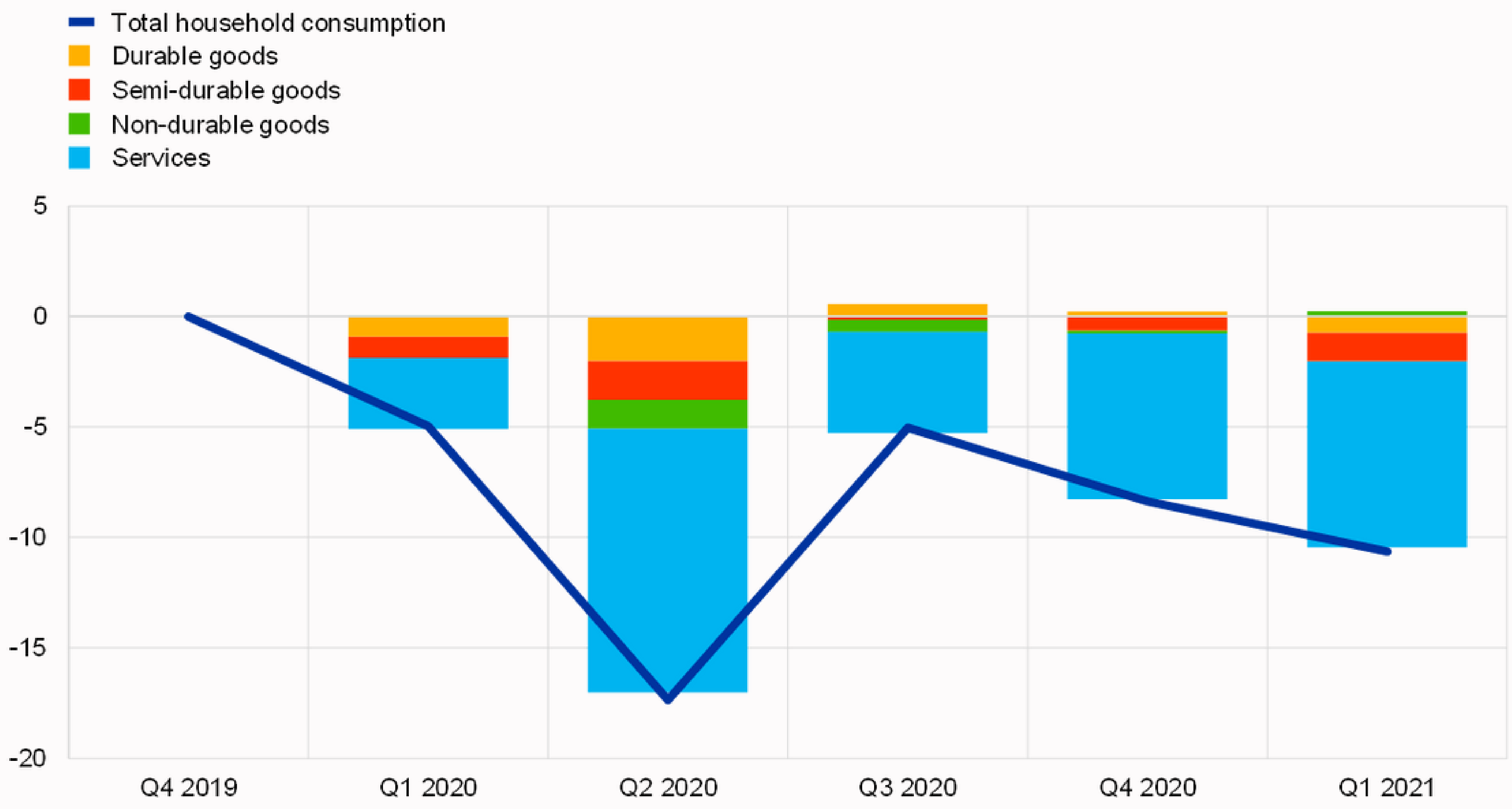
Liquidity Coverage Ratio analysis



Liquidity Coverage Ratio analysis

Developments in euro area private consumption

(change with respect to Q4 2019, percentage points)



Source: ECB

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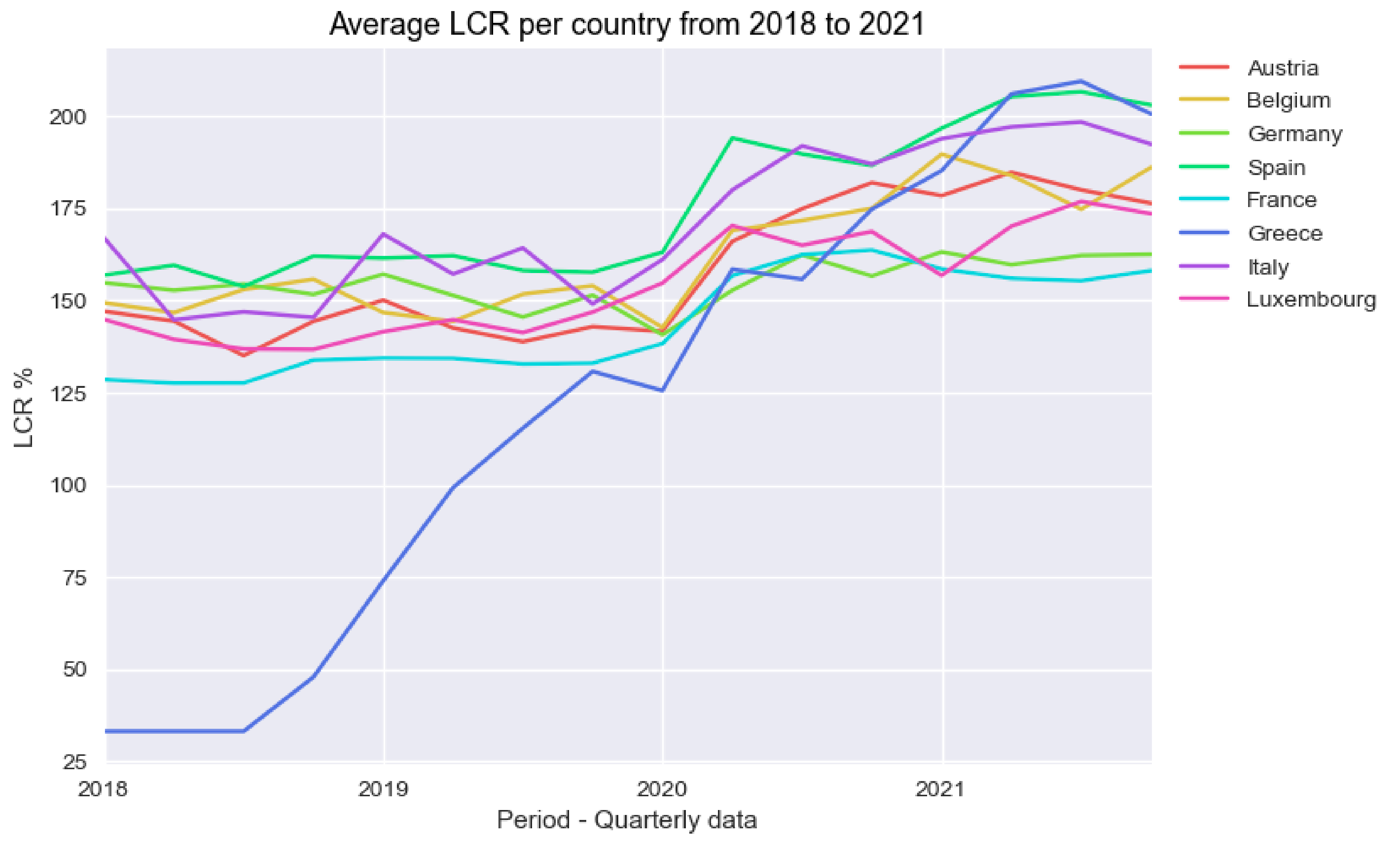
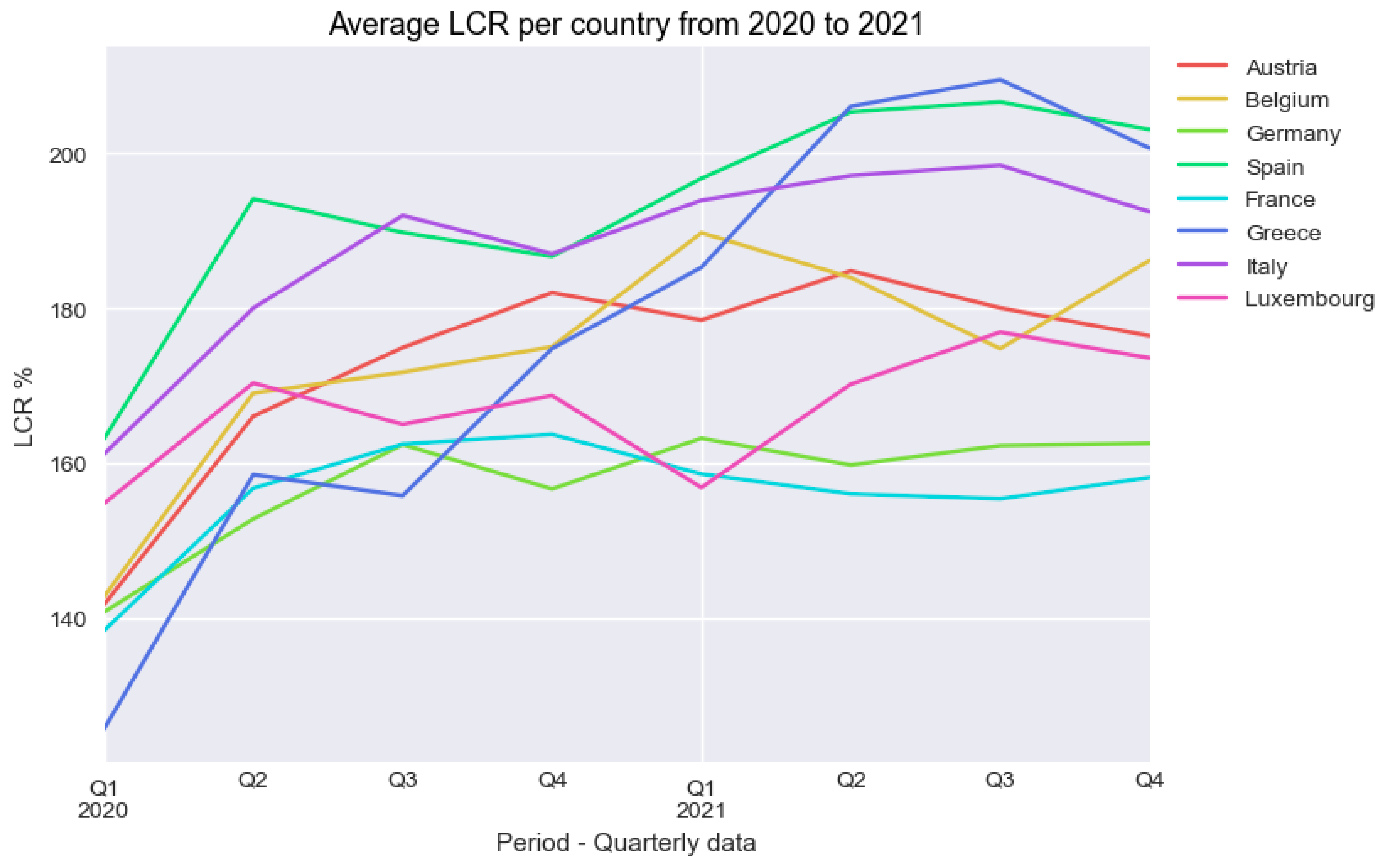
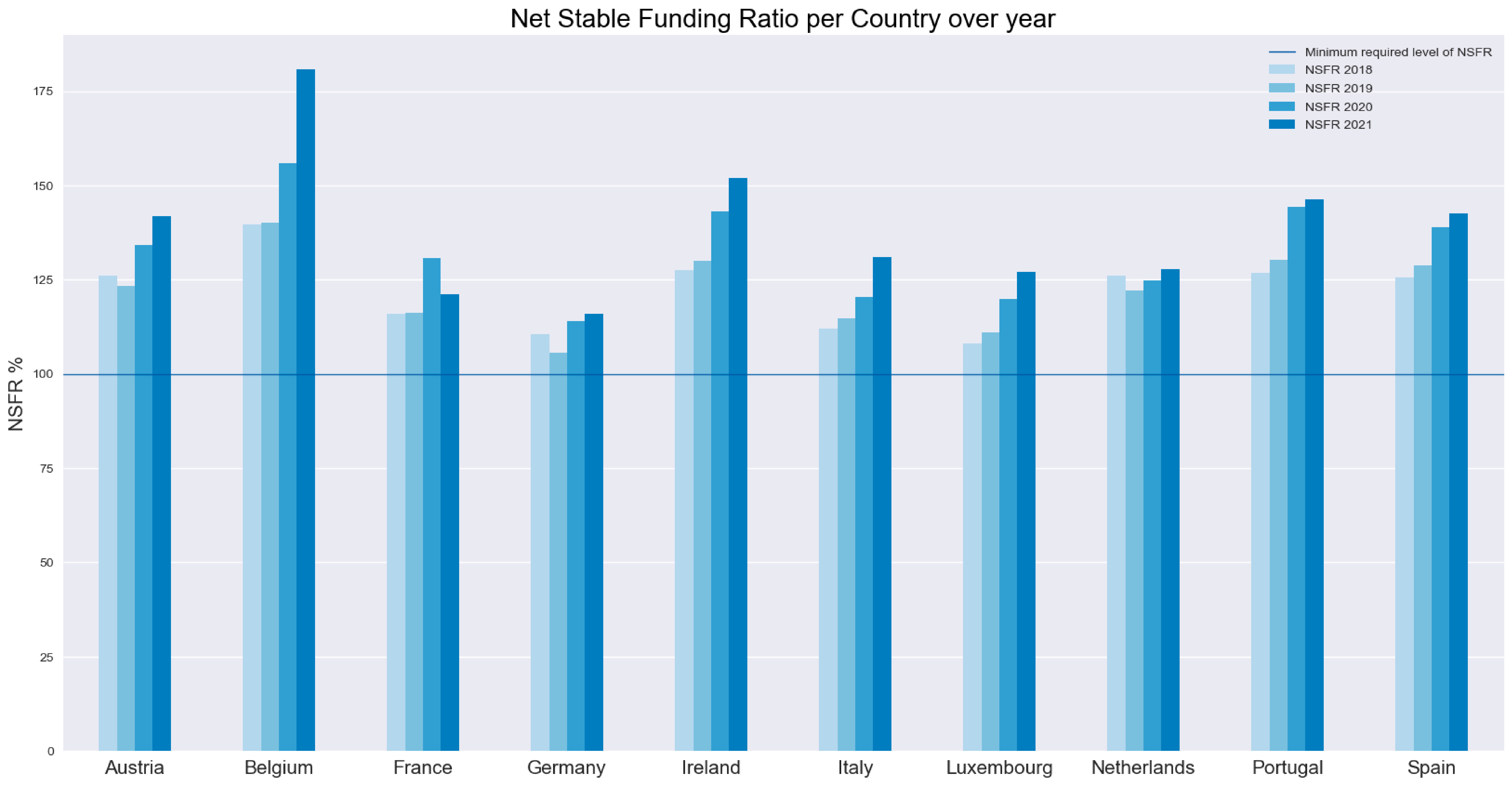
Liquid Coverage Ratio analysis





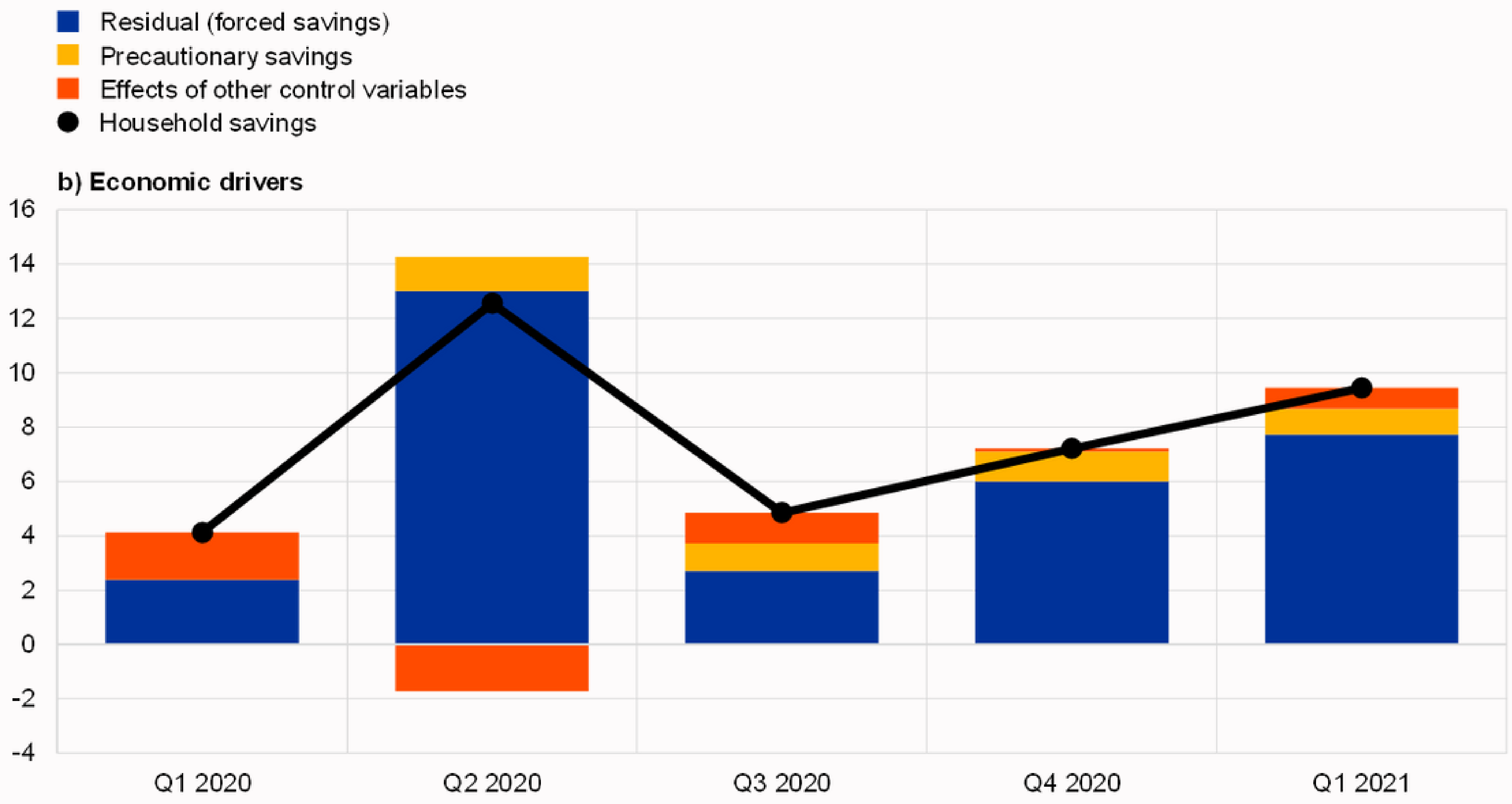
Net Stable Funding Ratio analysis



Net Stable Funding Ratio analysis

Household saving rate

(change with respect to Q4 2019; percentage points of disposable income)



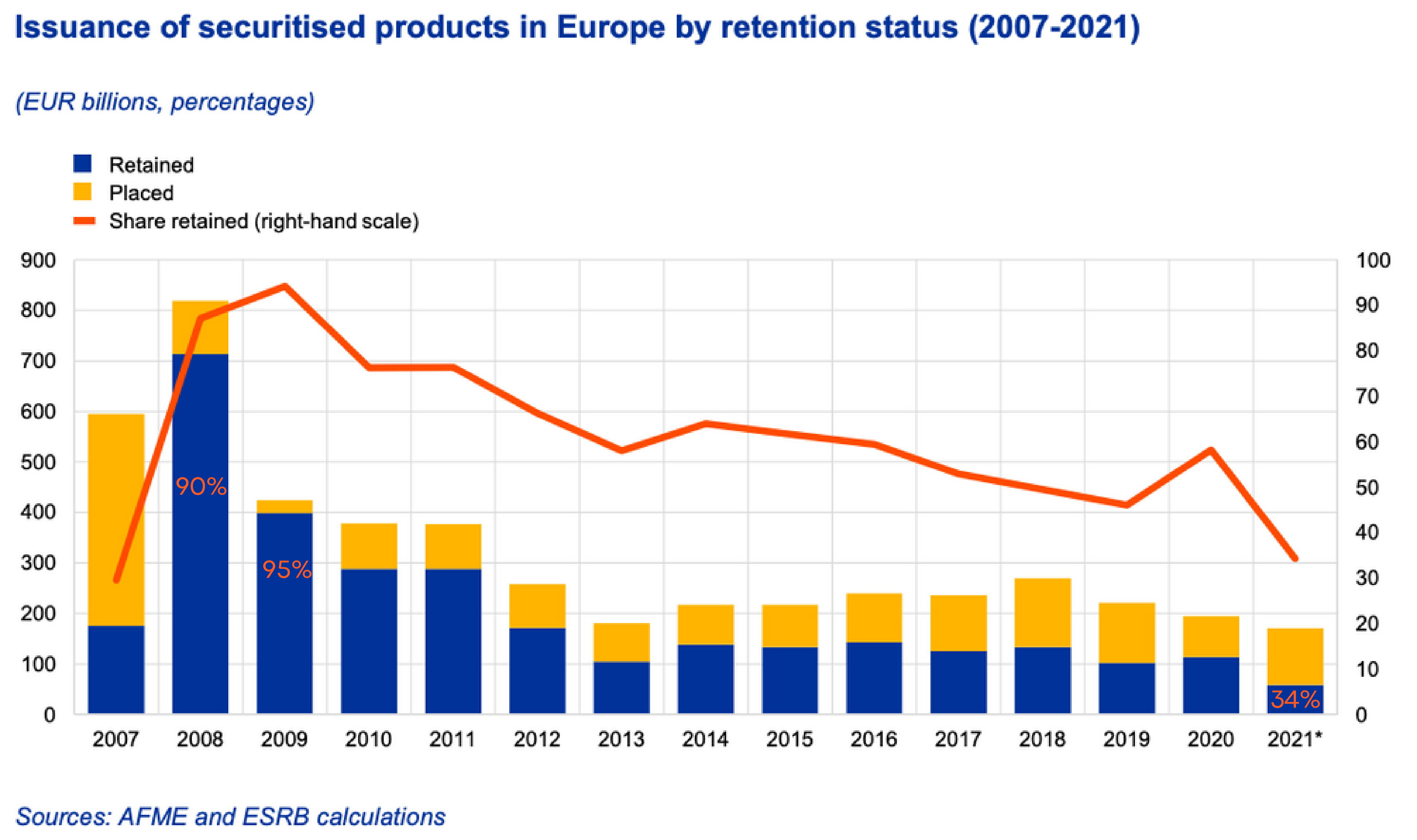
Source: ECB

NSFR and securitisation

Even if securitisation is a good practice for banks since it creates right-available liquidity by selling huge amount of credit to SPV, it has been a practice of banks in the past to create SPVs with the purpose of cleaning their balance sheet from risky loans (shadow banking system).

This could create liquidity risk situations that eventually spill in systemic bank crisis, notably when banks have huge amount of retained securitisations.
This happened during the 2008 crisis, when banks sold credit towards collateralized risky loans' (often mis-rated) leveraging on an inflated house market.

Thanks to NSFR and its mechanism of controlling off balance sheet (OBS) items through RSF (denominator), EU banks are now more penalized for the incorrect use of structured investment vehicles .



Off-balance-sheet (OBS): assets or liabilities that do not appear on a company's balance sheet. Securitisation is one example of OBS.

> *"Many potential OBS liquidity exposures can lead to significant liquidity drains in times of market or idiosyncratic stress" - Basel III, BIS.org*

Net Stable Funding Ratio analysis

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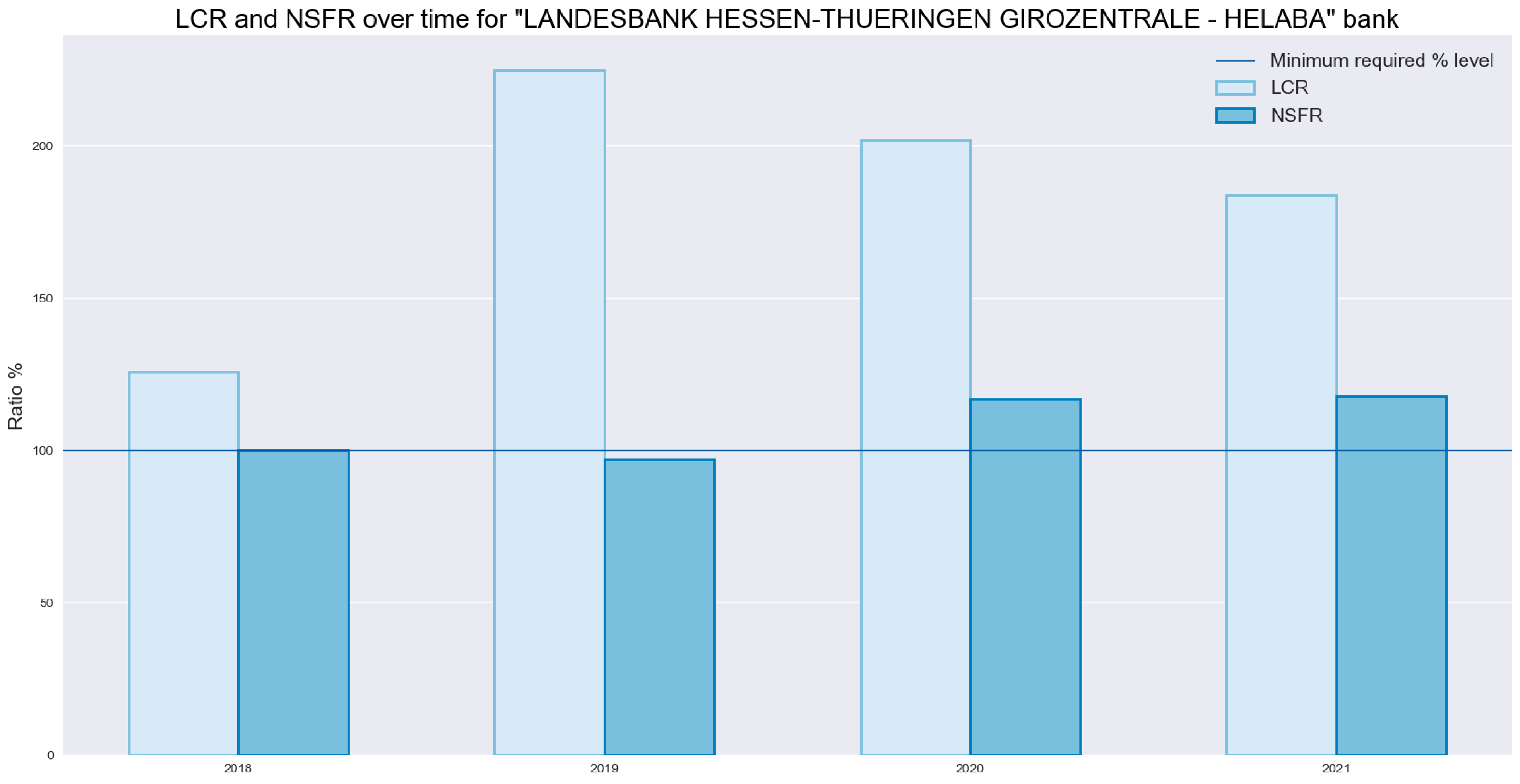
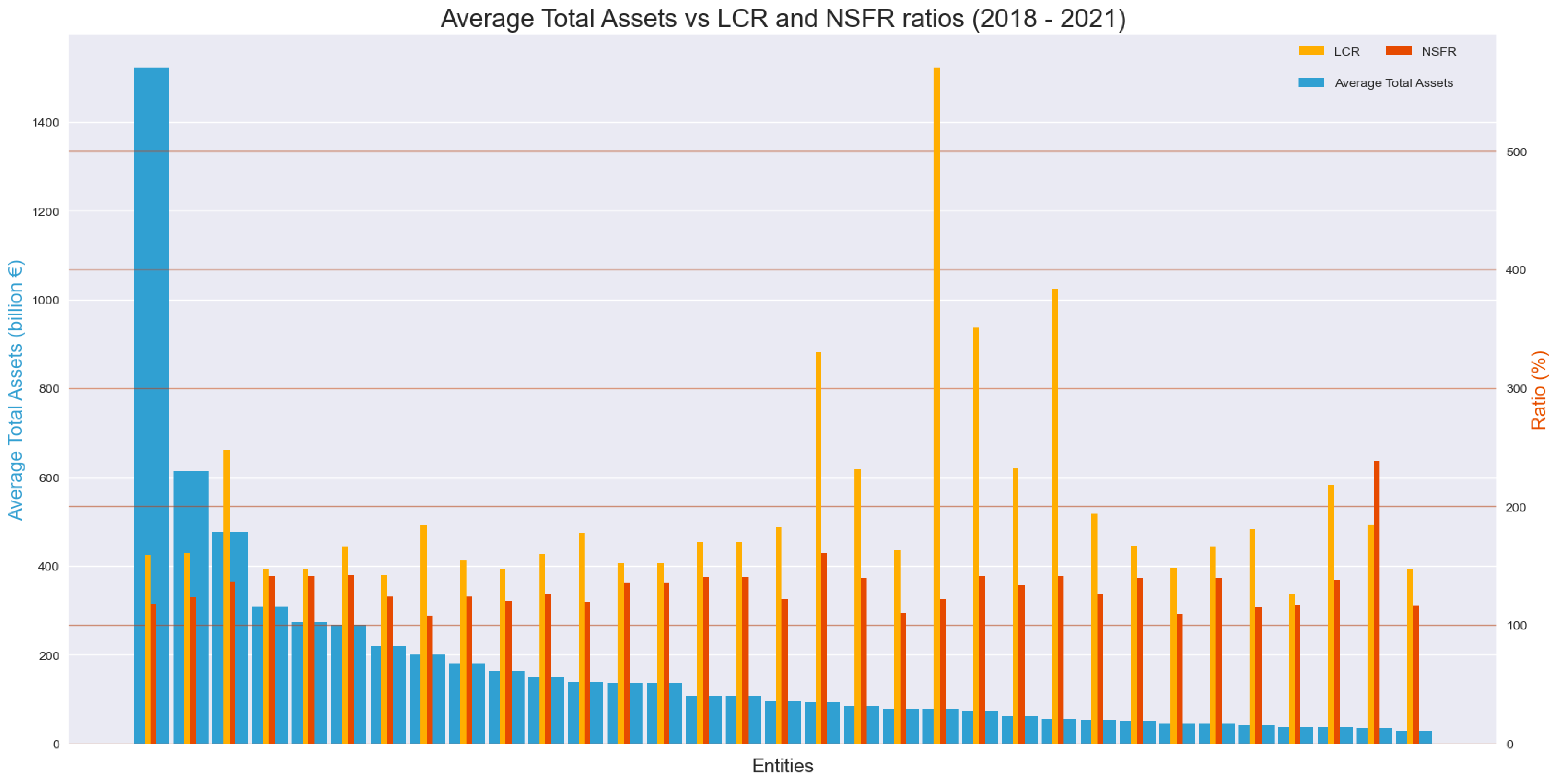
The only irregularity



Assets volumes and Ratios comparison



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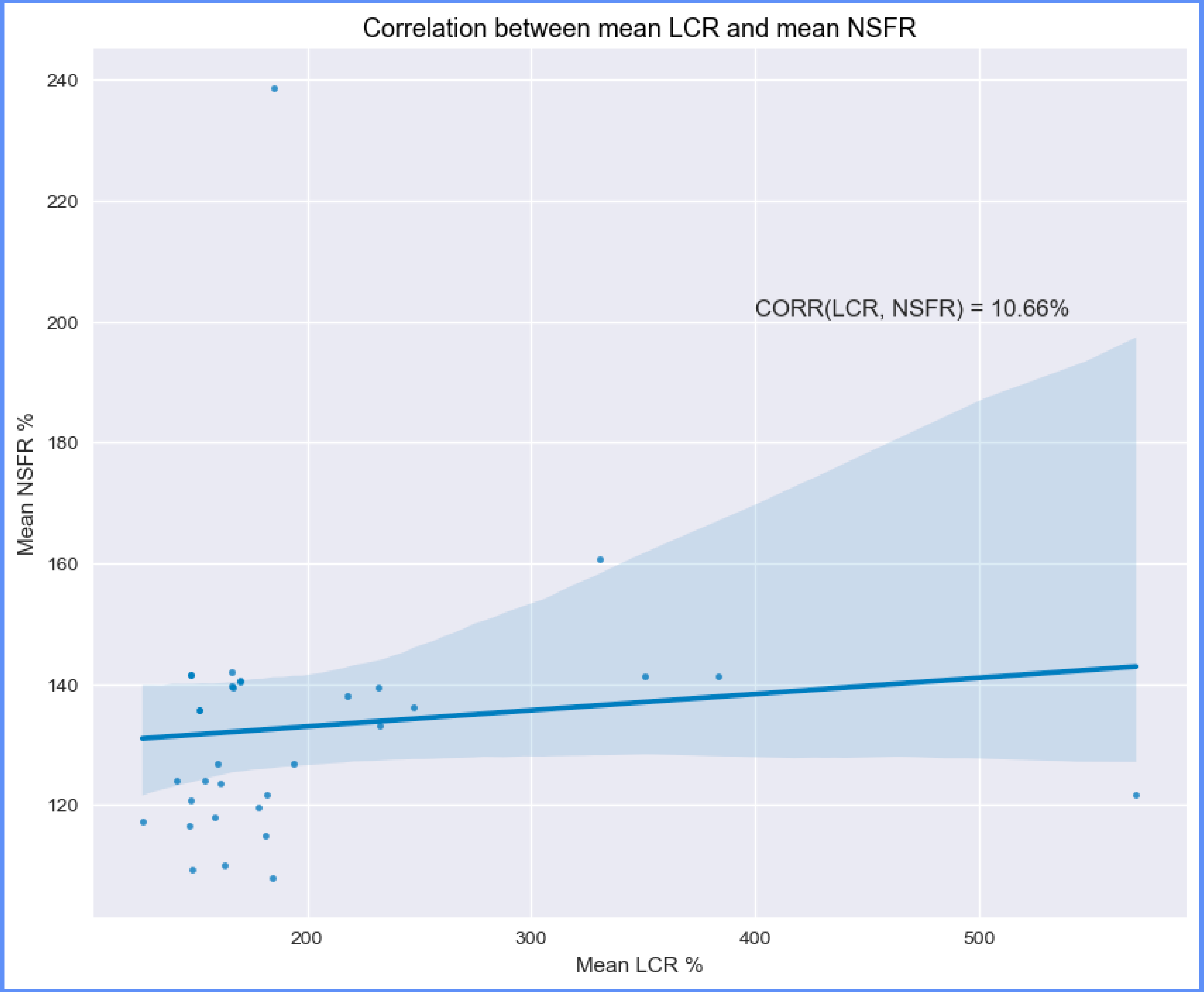
Correlation analysis



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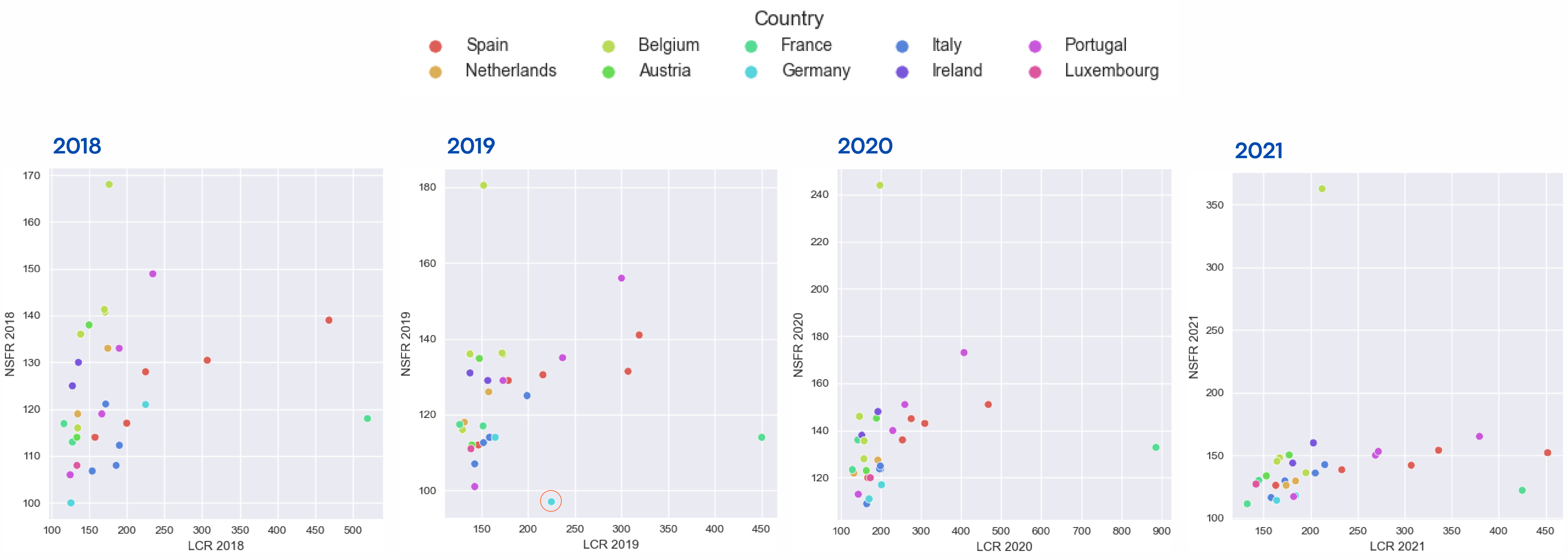
Correlation analysis

These relational plots present the LCR vs NSFR correlations each year by country



The ratios are in percentages

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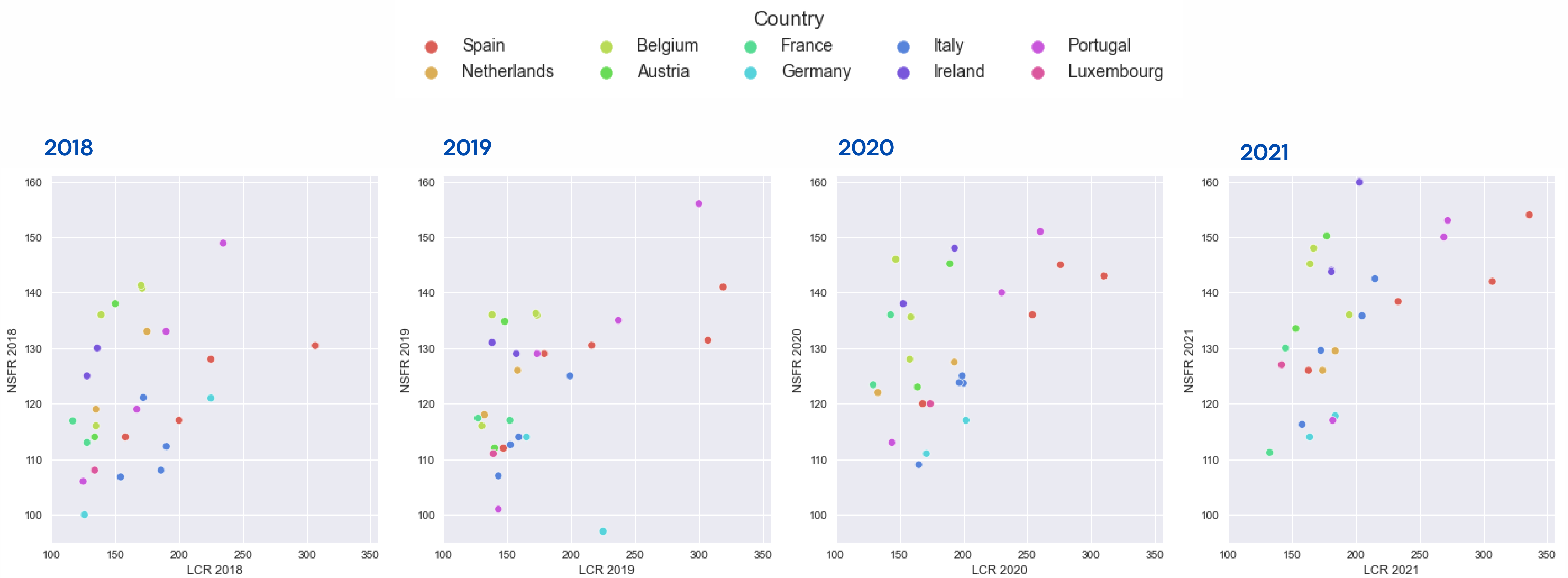

The ratios are in percentages

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Conclusions

Nearly all the banks from our sample respected liquidity ratios every year during the period of interest 2018-2021. As we presented in the analysis there was an average increase in trend for both LCR and NSFR, meaning that banks begun and continued to enhance their liquidity risk endurance, as intended by the Regulator.

This improvement in the liquidity ratios is due not only to the progressive changes in the minimum amount of the required ratios (started in 2016 and escalated until 2019), but additionally to broader systemic conditions dictated by the two years of the pandemic and by the monetary policy that impacted the Bond market Yield Curves.

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Thank you for your attention!