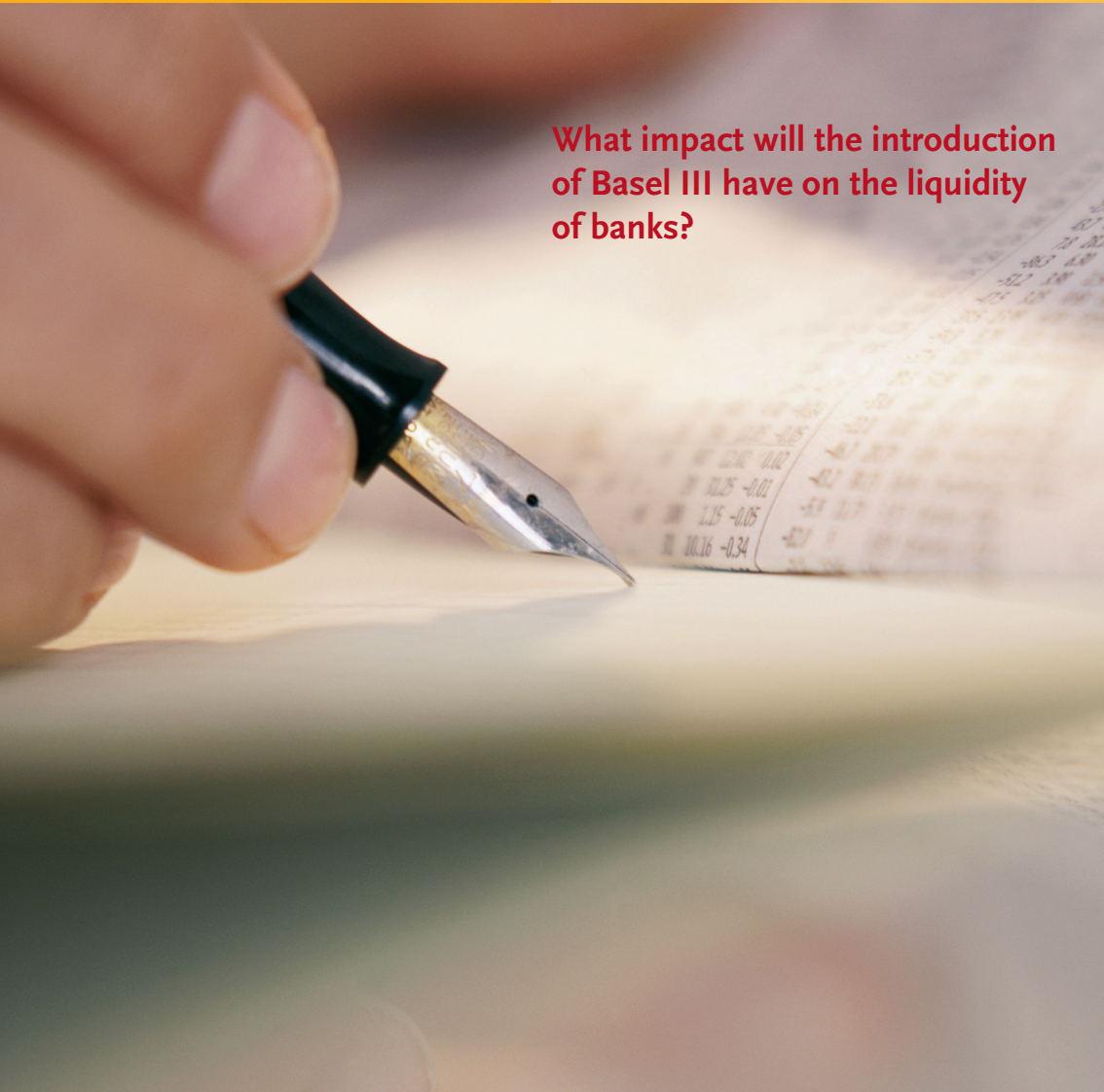


MAZARS
INSIGHT

**What impact will the introduction
of Basel III have on the liquidity
of banks?**



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1. Introduction	4
2. Local prudential regulations on the liquidity of credit institutions.....	5
3. Basel III measures and transposition into European law	9
4. Analysis of financial reporting.....	20
5. Conclusion	33

Introduction

The financial crisis of recent months came about not because of the credit crisis but because credit institutions had extreme difficulty in refinancing in the market - prudential supervision at the European level had taken no account of the liquidity criteria.

In response to the difficulties encountered by banking institutions when refinancing on the markets from 2008 onwards, the Basel Committee proposed the introduction of a short-term (Liquidity Coverage Ratio) and long term (Net Stable Funding Ratio) liquidity ratio. These ratios are proposed in order to measure the resilience of banks in the event of massive withdrawals. One of the direct consequences of implementing these ratios is the exhaustive analysis of institutions' asset portfolios in order to optimise these regulatory liquidity ratios, which will entail a review of European credit institution strategies.

After reviewing the current regulation of liquidity in Europe, Mazars presents the Basel Committee liquidity measures and their transposition into European law as published in July 2011.

At the same time, Mazars wished to analyse the financial reporting of a varied sample of European banks on the subject of liquidity since the end 2010 in order to identify the preferred approaches and to assess the changes which are already emerging in response to a matter which is of concern to investors.

Local prudential regulations on the liquidity of credit institutions

In order to compare the situations of the different credit institutions in its sample, Mazars has analysed the regulations in force in the countries where these institutions operate.

Mapping local liquidity regulations				
Country	Source	Qualitative requirements	Quantitative requirements	
			Short-term	Long-term
Germany	German Federal Financial Supervisory Authority (BaFin)	X	1 month	1 month to 1 year
UK	Financial Services Authority (FSA)	X	2 weeks	3 months
Belgium	National Bank of Belgium	X	1 week to 1 month	-
Spain	Banco de España	X	-	-
France	Autorité de contrôle prudentiel (ACP)	X	1 month	-
Ireland	Central Bank of Ireland	X	8 days	1 month to more than 2 years
Italy	Banca d'Italia	X	-	-
The Netherlands	Central Bank of the Netherlands (DNB)	X	1 week to 1 month	1 year
Switzerland	Autorité Fédérale de surveillance des marchés financiers (FINMA)	X	1 month	-

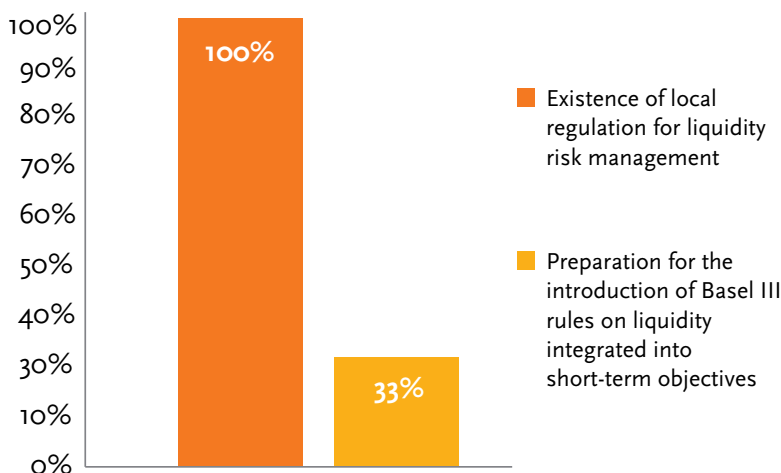
* This analysis was carried out on the basis of the data available on the regulators' web sites and is not intended to provide an exhaustive overview of existing measures.

The quantitative requirements presented above may be either ratios to be met, or reports to be made to the regulators.

Based on the analysis of liquidity information reported by these nine local regulators, we have identified several points of comparison: regulators' reports on the Basel III liquidity measures, the manner of updating local prudential regulation and the nature of existing local liquidity requirements.

REGULATORS' COMMUNICATIONS ON THE BASEL III LIQUIDITY MEASURES

All national regulators have local liquidity risk management regulations and explain the role of the Basel Committee's role in drafting liquidity rules internationally.



METHOD OF UPDATING LOCAL PRUDENTIAL REGULATIONS

Regulators are taking a variety of approaches to the updating of national regulations. Two main approaches have been identified:

- A majority of regulators (Germany, Belgium, Spain, France and Italy) regularly update their liquidity regulations in response to the conclusions of working parties. These working parties are in general made up of representatives of the regulator and of the country's principal banks.

Local prudential regulations on the liquidity of credit institutions

- The other regulators (the UK, Ireland, the Netherlands and Switzerland) have recently conducted an overall review of their supervisory systems (at the end of 2010 or during 2011), usually following a phase of general consultation of the banking sector.

TYPE OF LIQUIDITY REQUIREMENTS

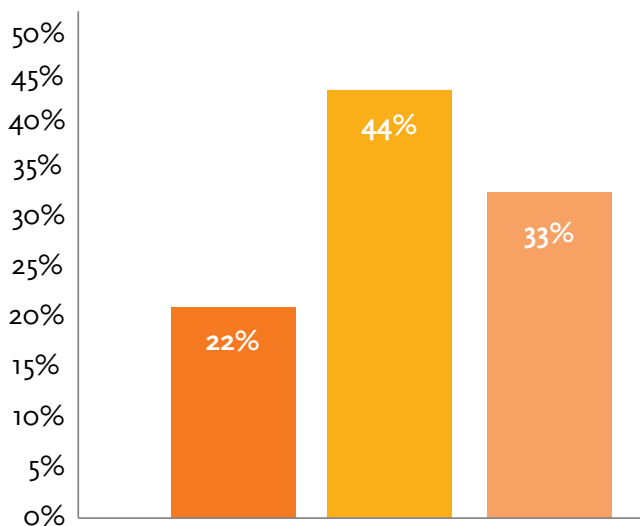
The requirements formulated by national regulators for the liquidity of credit institutions vary from one country to another.

78% of regulators have formulated both qualitative and quantitative requirements:

- **Qualitative supervision** relies chiefly on the regulator's assessment of credit institutions' prevention and liquidity risk management systems. The aims of this assessment are consistent overall, but the level of details communicated on the conditions under which these studies are conducted vary greatly. Some regulators continue to take a less specific approach, and talk of a 'broad-based assessment' while others list the exact criteria to be fulfilled.
- **Quantitative requirements** for liquidity include minimum liquidity ratios and liquidity monitoring tables. The level of detail monitored varies greatly. Regulators require banks to have a maximum visibility ranging from one to two months, often with daily or weekly monitoring for the short-term, and monthly then quarterly monitoring for the long-term.

Two of the nine countries analysed (Spain and Italy) have set out no quantitative liquidity requirements and have only established qualitative supervision.

On the basis of this analysis, it is possible to identify three categories reflecting the level of requirements and the updating of liquidity rules by the national regulators studied.



Classification of regulators by level of requirements and updating of liquidity rules

- Level 1 (Spain, Italy): qualitative requirements only, little communication on Basel III liquidity measures
- Level 2 (Germany, Belgium, France, Switzerland): qualitative requirements and quantitative monitoring of liquidity, detailed communication on Basel III liquidity measures
- Level 3 (UK, Ireland, the Netherlands): advanced level of qualitative and quantitative requirements, preparation for the introduction of Basel III liquidity rules integrated into the regulator's short-term objectives

National regulations in terms of liquidity diverge across Europe. Despite the existence of rules for the liquidity of banks in all the countries studied, the nature of these rules and the level of requirements established by national regulators vary greatly. Some countries (the UK, Ireland, the Netherlands) are more advanced than others in their implementation of the Basel III liquidity measures.

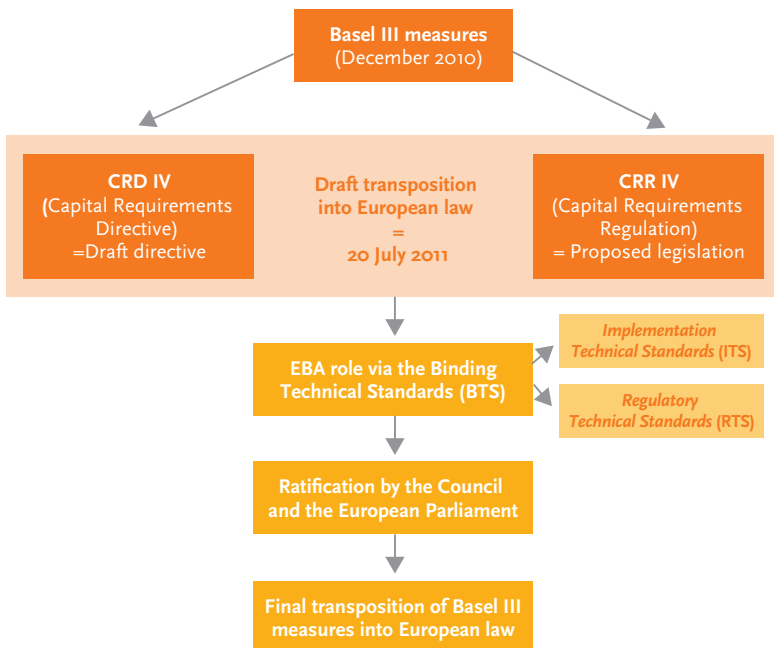
Basel III measures and transposition into European law

The Basel III measures, including the new rules on liquidity, were published in December 2010. These measures have the status of proposals, and must be transposed into law before they come into force. On 20 July 2011, a legislative package (a regulation and a directive) transposed these measures into European law, replacing the previous directive.

This package, generally known as the Capital Requirements Directive (CDR IV), consisted of:

- **A draft regulation, the CRR** (Capital Requirements Regulation), applicable directly without need for a national regulation;
- **A draft directive, the CRD IV** (Capital Requirements Directive). This draft requires national interpretation before introduction.

This challenge of this draft transposition is to make the Basel text applicable in the form of a single Europe-wide regulatory corpus in order to avoid divergent national interpretations.



The Basel III measures relating to liquidity ratios (LCR and NSFR) appear in the CRR and their implementation will require no national interpretation. However, the definition of a number of technical points and implementing arrangements has been entrusted to the Europe Banking Authority (EBA) via the definition of Binding Technical Standards (BTS). The EBA will conduct a series of studies during the observation period to develop the points not defined in the draft regulation, which will then be the subject of direct application in national law. By 2017, 112 BTS will have been published by the EBA to enable the introduction of all the Basel III measures; 41 of these are due before 2013)

The BTS developed by the EBA will take the form of:

- Regulatory Technical Standards (RTS): clarifications for inclusion in the draft regulation and directive;
- Implementing Technical Standards (ITS): the arrangements for implementation of the regulations and of the directive. The ITS will cover the future reporting of liquidity ratios.

To be applied directly in national law, the BTS must be adopted in the form of regulations or decisions by the European Commission. In the case of the RTS, the Council or the European Parliament can exercise its right of veto.

LIQUIDITY COVERAGE RATIO (LCR)

The LCR is a short-term cash-flow ratio that aims to ensure that a bank has sufficient liquidity on hand to ride out cash outflows in an extreme stress scenario over a period of 30 days. Under these circumstances, the banks should hold liquid assets equal to at least 25% of the outflows during the month.

This ratio must enable each institution to measure its resistance to market stress over a one month period. It is calculated as the ratio between a “stock of high-quality liquid assets” and “net cash outflows over a 30-day time period”; a credit institution must hold at least 25% of net cash outflows in liquid assets.

Basel III measures and transposition into European law

$$\frac{\text{Stock of high quality liquid assets}}{\text{Net cash outflows over a 30 day time period}} \geq 100\%$$

ou

$$\frac{\text{Liquid assets}}{\text{Outflows - [min (inflows; 75% of outflows)] at 1 month}} \geq 100\%$$

The Basel text defines the elements in the LCR calculation very precisely.

- Numerator: “High quality” liquid assets** are classified into two levels, determining their weighting. The eligibility of assets for the “high quality” category corresponds to the ability to transform them rapidly and without significant discount into cash on the markets during stress periods. A 15% haircut is applied to level 2 assets to take account of the loss of value these assets are likely to undergo when transformed into cash. Additionally, total level 2 assets may not represent more than 40% of a bank's total stock of high-quality liquid assets.

High quality liquid assets – Classification of assets and weightings in the LCR		
Level 1 assets	Cash	100%
	Eligible marketable securities issued by states, central banks, public organisations or multilateral development banks	100%
	Central bank reserves, constituted of eligible assets	100%
	Domestic securities issued in foreign or local currency by sovereign entities or central banks for non-0% risk-weighted sovereign borrowers	100%
Level 2 assets	Securities issued by states, central banks, public organisations or multilateral development banks assigned a 20% risk weighting	85%
	Corporate bonds and eligible covered bonds rated AA- or above	85%

- In the denominator, the net cash outflows at 30 days are calculated on the basis of the inflows and outflows over the month in question. The various items eligible in the LCR denominator are weighted to reflect their likelihood of occurrence during a crisis period.

OUTFLOWS = Outgoing cash		INFLOWS = Incoming cash		LIKELIHOOD OF OCCURRENCE ↑ +
Current and deposit accounts	0%-10%	Reverse repos and securities borrowing transactions	0%-100%	
Unguaranteed wholesale funding (small enterprises, credit institutions, public institutions, other legal entities)	5%-10%	Credit or liquidity facilities	0%	
		Operational deposits held in other financial institutions	0%	
Guaranteed funding	0%-100%	Amounts receivable from retail customers	50%	
		Amounts receivable from non-financial counterparties	50%	
Additional requirements (sureties following margin calls, variations in market value of derivatives, securitisations, miscellaneous commitments, net total payable on derivatives, etc.)	5%-100%	Amounts receivable from financial institutions	100%	+
		Net receivable on derivatives	100%	

The LCR must be notified at least once a month, during the 15 days following the reporting date. This rate may be weekly or even daily if the national regulator so requires.

Basel III measures and transposition into European law

Transposition into European law will bring about the following main differences from the measures set out above:

- ◇ While the Basel text is very detailed on the elements that can be included in the calculation of this ratio, the European regulation is less precise. For example, it allows covered bonds in the LCR numerator. The EBA is responsible for providing more details on “high quality” liquid assets through the publication of BTS.
- ◇ The LCR will not come into force automatically. The Commission must adopt a delegated act (delegation granted until the end of 2015).
- ◇ The European Community has made several additions to the Basel text in terms of the monitoring to be carried out:
 - Banks are required to draw up a precise report on the pool of liquid assets and the net cash outflows used in calculating the LCR;
 - Banks are also required to conduct a calculation per currency;
 - As from 2013, banks will be obliged to hold an ‘appropriate’ level of liquid assets determined by national regulators. In France, this level corresponds to the liquidity coefficient as defined by the Banking and Financial Regulation Committee (CRBF, decision of 5 May 2009).

The LCR continues to be the subject of many comments and criticisms from the banks, not least in response to the preceding liquidity crisis:

- Numerator - the criteria for eligibility in the liquidity reserve are considered to be too restrictive, and exclude:
 - > Assets eligible for central bank refinancing. The regulator believes that central banks should not take the role of lender of first resort;
 - > Assets issued in the equity market considered unmarketable in stress periods without substantial impairment.

Further, in a crisis period a limitation on realisable assets may lead to a wave of disposals of these same assets, leading to impairment of the liquid reserve.

- Denominator:
 - > The determination of the LCR rests on asymmetric scenarios. For example, drawings on funding commitments in a crisis period leads to a coefficient of 100%, the impact of which is at the cash outflow level. In parallel, if the same institution holds a funding commitment received from another credit institution, it may not apply this undertaking in determining the LCR.
 - > The assessment of the concept a durable relationship is such as to bias the 'leakage rate' scenarios. Thus, the difference between 'leakage rates' for Corporate deposits (between 25% and 75%) and Retail deposits (between 5 and 10%) is regarded as too great.

NET STABLE FUNDING RATIO (NSFR)

The NSFR is a **stock ratio** at 1 year. It aims to ensure that the banks' stable funding is sufficient to resist prolonged periods of tension in a generally stable context. Unlike the LCR, which measures the resilience of banks to market stress, the NSFR attempts to measure the resistance of a bank to a crisis in the bank itself.

The introduction of this ratio aims to ensure that the banks' asset and liability activities are managed by promoting the employment of stable funding to finance activity over one year.

The NSFR is the ratio between stable funding and the funding requirements at one year:

$$\frac{\text{Stable funding at 1 year}}{\text{Funding requirements at 1 year}} \geq 100\%$$

Basel III measures and transposition into European law

The Basel text provides a detailed list of elements eligible in the calculation of the NSFR. Weighting is applied, reflecting stability in the case of funding and the liquidity of assets for funding requirements. The weighting takes account of the nature and maturity of the products/instruments, and the nature of counterparties.

ASSETS Funding requirements at 1 year = Denominator		LIABILITIES Stable funding at 1 year = Numerator		
LIQUIDITY OF ASSETS + ↓ -	Liquid assets and securities with residual maturity < 1 year	0%	Equity instruments (T1 or T2) + other liabilities with effective maturity ≥ 1 year	100%
	Debt securities (sovereigns, central banks etc.) with a 0% risk weighting / standard Basel II approach	5%	Stable personal and SME business deposits (no maturity date, or residual maturity < 1 year)	90%
	Corporate debt securities (> AA- and > 1 year)	20%	Less stable personal and SME business deposits (no maturity date, or residual maturity < 1 year)	80%
	Corporate debt securities (between A+ and A- and > 1 year)	50%	Funding from non-financial institutions (no maturity date, or residual maturity < 1 year)	50%
	Guaranteed housing loans > 1 year	65%	Other liabilities	0%
	Personal and small business loans (< 1 year)	85%		
	Other assets	100%		

Thus, the more illiquid the assets, the more necessary it will be to hold safe funding (i.e. stable – low probability of outflow) which will make it possible to finance these assets in a stress scenario.

The NSFR must be notified at least a once a quarter, within 15 days of the reporting date. However, it must be monitored continuously by credit establishments in order to control the liquidity risk.

The principal divergence between the Basel Committee's proposals and the draft European regulations relates to the actual application of the NSFR, which has not been confirmed. Impact studies are planned until the end of 2016, and under the terms of the draft transposition the decision on whether or not it would be appropriate to introduce the NSFR will not be taken until 2017 (by the co-decision procedure), whereas Basel III anticipates that it should be a minimum standard from 1 January 2018.

As in the case of the LCR, the European regulation is less precise as to the eligible items; banks should submit a detailed report explaining which elements are included in the calculation.

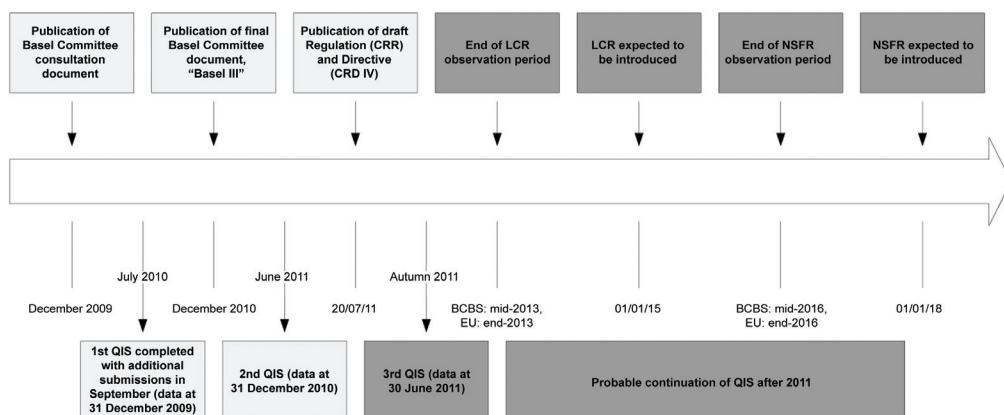
The main discussions around the NSFR relate to:

- a challenge to the transformation role of banking, due to the requirement to have long-term funding to support long-term operations.
- The probable reduction of the capacity of banks to provide long-term credit as a result of the difficulty of finding long term refinancing on the markets, which would penalise the provision of back-up credit lines to enterprises, the financing of local authorities and the financing of international trade.
- The risk of disintermediation of enterprise funding (securitisation, financing by 'non-banks') as a result of the inability to obtain funding from the banks, which runs counter to the objectives of banking regulation.
- The probable increase in recourse to securitisation operations (which lay at the origin of the subprime crisis) in order to avoid the long-term refinancing of some loans/activities.
- The need for entities whose assets have short maturity (like factoring businesses) to refinance a significant portion of their activities in the long term (50% for short-term loans to businesses).
- The increase in refinancing costs in the market.

Basel III measures and transposition into European law

TIMETABLE FOR APPLICATION

This timetable is that proposed by the Basel Committee, but it may be subject to revision, since there is no equally precise timetable for transposition into European law at this stage.



FINANCIAL IMPACT

The Basel Committee has introduced Quantitative Impact Studies (QIS), conducted during the observation period, the aim of which is to assess the impact on economies of the introduction of the LCR and the NSFR. Depending on the results, the concepts of these ratios will be refined (notably by the EBA in Europe). In order to conduct this exercise successfully, the Basel Committee is providing credit institutions with tools with which to estimate the impact of the new standards on liquidity ratios (these documents are accessible at: <http://www.bis.org/bcbs/qis/biiimplmoniwb.xls>).

In December 2010 the Basel Committee published the result of the Quantitative Impact Study 1 (QIS 1) carried out on the basis of data available at the end of 2009. This study was conducted on two sets of banks:

- > Group 1: banks that have Tier 1 capital in excess of €3 billion, are well diversified and are internationally active;
- > Group 2: other banks.

		BCBS (world)	CEBS (EU)
Total no of banks		169	230
Average LCR	Group 1 calculation	83%	67%
	Group 2 calculation	98%	87%
	Banks whose LCR > 100%	46%	Not available
Average NSFR	Group 1	93%	91%
	Group 2	103%	94%
	Banks whose NSFR > 100%	43%	Not available
	Banks whose NSFR > 85%	67%	Not available
	Estimated shortfall	€2 890 billion	€1 800 billion

An update of this study, based on the data at 31.12.2010, was carried out at the beginning of 2011, but its results have not been made public (QIS 2). A new update is in progress (QIS 3).

In addition to the QIS, other studies are regularly conducted with the aim of quantifying the shortfall of assets/stable funding to meet the ratios. One of the more recent studies was conducted by JP Morgan Chase, in a memorandum to the market in September 2011, and demonstrates that

Basel III measures and transposition into European law

only 25% of a sample of 28 European banks meet an LCR of over 100%, which would translate into a shortfall of assets of €493 billion across the sample as a whole.

Analysis of financial reporting

Mazars' analysis is based on the financial reporting of 19 European credit institutions. The information was taken from:

- 2010 annual reports, for the qualitative data;
- Analytical slides and other documents published during the presentation of Q3 2011 accounts, for the quantitative data.

Country	Credit institution
Germany	Commerzbank Deutsche Bank
UK	Barclays HSBC Lloyds Banking Group RBS
Belgium	KBC
Spain	BBVA Santander
France	BNP Paribas BPCE Crédit Agricole SA Société Générale
Ireland	Bank of Ireland
Italy	Intesa Sanpaolo Unicredit
Netherlands	ING
Switzerland	Crédit Suisse UBS

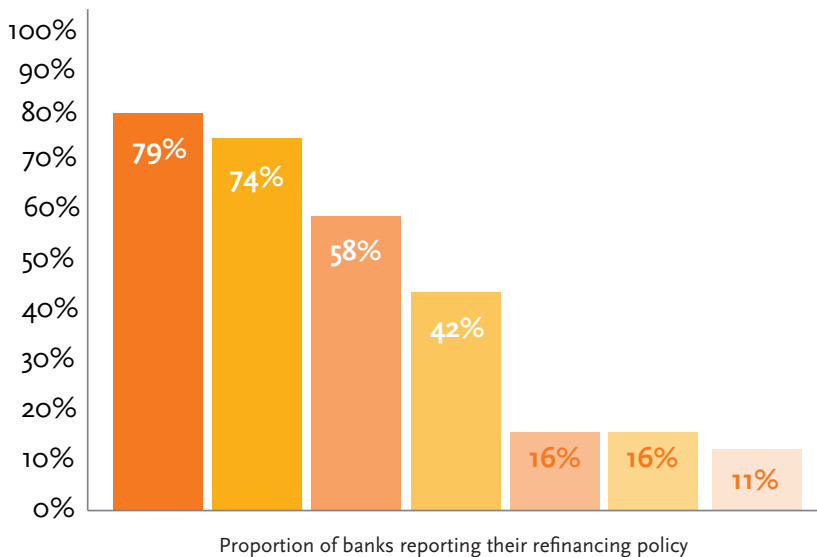
Mazars' analysis relates both to the qualitative information generally provided in the annual report, and to the quantitative data contained in quarterly reports. This comparison is made against a background where there are very few regulatory requirements for the banks to report on liquidity risk apart from IFRS7 (which requires qualitative disclosures on liquidity risk management along with the other financial risks to which the bank is exposed, and which also requires a timetable of liabilities).

Thus, most of the data reported by the banks in our sample relate to the information which the banks think it relevant to provide to the market in response to investor expectations.

ANALYSIS OF QUALITATIVE DATA

The 2010 annual reports for the selected banks provided a good deal of information on liquidity. The study shows that the banks' reporting in terms of qualitative data has two main thrusts: refinancing policy and liquidity risk management.

Refinancing policy



- Diversification of funding sources
- Importance of retail business
- Diversification of currencies
- Importance of holding liquid assets
- Diversification of maturities
- Optimisation of liquidity management
- Independence of markets

Among the topics developed by credit institutions in their description of liquidity monitoring, four most commonly emerge:

- **The diversification of refinancing sources**

79% of banks report on their diversification of finance sources policy, mainly highlighting:

- > **The nature of the sources:** Retail, wholesale and capital and reserves;
- > **Types of instruments:** Unsecured / secured issues - covered bonds (obligations foncières, Pfandbriefe, mortgage bonds, housing bonds), securitisation, long term, repos, state-guaranteed issues, etc.
- > **The diversification of their investor base.**

- **The importance of retail business**

Following the crisis, the banks are trying to demonstrate their reduced dependence on the markets for refinancing. For this, several tools are highlighted:

- > **The loan-to-deposit ratio**, which records the relative importance of loans granted and deposits taken;
- > **The total customer deposit to total asset ratio**, which is used to stress the significance of the Retail Banking business as compared to Corporate and Investment Banking or Asset Management.

Echoing the Basel Committee's recommendations for the introduction of the NSFR, the principle of stable funding is also a subject often raised by the banks ("Customer deposits provide large pools of stable funding"/"stable base"/"stable deposit base"/"stable deposits"). For the purposes of calculating the NSFR, the concept of stability makes it possible to determine the percentage of deposit leakages. Thus, the better developed the customer relationship, the higher the stability and the lower the likelihood of deposit leakages at times of crisis, which makes it possible to refinance a credit institution's assets (high stability equals greater weighting of deposits).

● Diversification of foreign currency refinancing

The 11 institutions which reported on their currency refinancing policy adopted two different approaches:

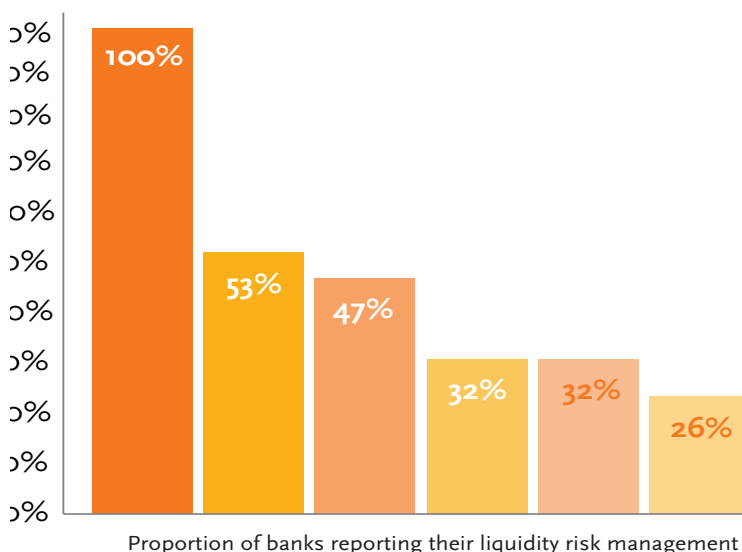
- > two-thirds only mention their capacity to refinance on several currency markets, without quoting the markets;
- > one-third report on their ability to issue medium to long-term debt on their principal markets (EUR, USD, AUD, CAD, JPY).

● The importance of holding liquid assets

The management of liquid assets is an aspect reported by 42% of the banks in the sample. They highlight their capacity to calibrate their liquid assets on the basis of stress test results with a view to responding at any time to any liquidity gap, and thus to replace market finance wholly or in part. This policy of holding liquid assets differs from the principles recommended by Basel III in terms of liquidity:

- > The banks report on their holdings of liquid assets acceptable to central banks in order to refinance without recourse to the markets in a stress scenario (the amount of assets calibrated after conducting stress tests);
- > The Basel Committee has defined the concept of high quality assets available at all times in a very stressed context by excluding assets accepted by the central bank, believing that it is not the job of the latter to meet the liquidity needs of credit institutions.

Liquidity risk management

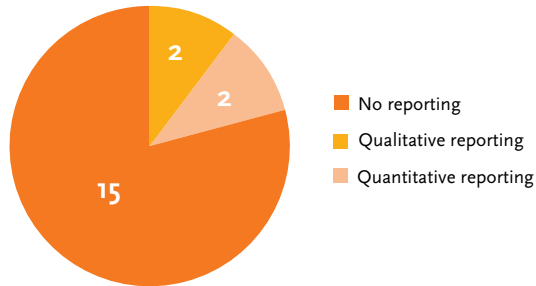


- Stress tests and crisis scenarios
- Liquidity gap – introduction of alarm measures and limits
- Regular static and dynamic analyses
- Liquidity risk management per currency
- Compliance with local regulatory constraints
- Diversification policy of liquidity risk

All the banks studied provide information on the existence of emergency plans to prevent and manage liquidity crises. For this, they conduct stress tests and simulate crisis scenarios with a view to assessing the amount of liquidity and liquid assets necessary to continue business and survive closure of the markets during a period of crisis. This monitoring of inflows and outflows in stress periods corresponds to the recommendations of the Basel Committee for the calculation and monitoring of the LCR, but little information is reported on the stress scenarios applied.

Basel III liquidity ratios

Financial reporting on LCR and NSFR at Q4-10

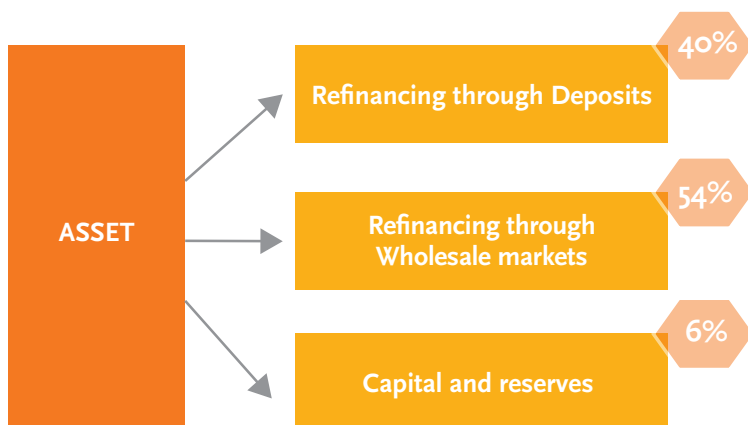


As from the end of 2010, the majority of credit institutions have mentioned the new liquidity ratios via a presentation of the broad principles in their annual reports. However, none of them have discussed the impact of the introduction of these rules on their activities. Likewise, quantitative data were rare at the end of 2010: only two institutions published quantifiable data on their NSFR and LCR at the end of 2010, noting that at that date they were not yet in compliance with the future rules.

At 30 September 2011, two new institutions mention a quantified NSFR, but no data is presented for the LCR.

ANALYSIS OF QUANTITATIVE DATA

The analysis of the publications of credit institutions at 30 September 2011 is used to develop a universal European banking model in terms of refinancing of activities:



Refinancing through Deposits

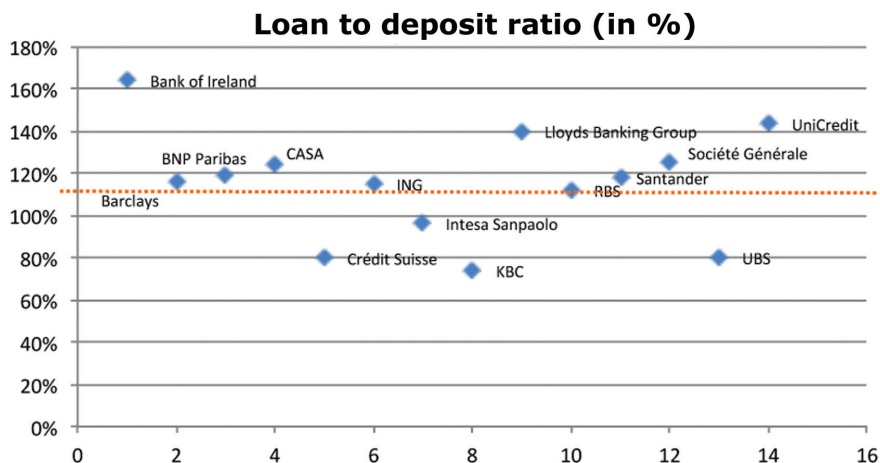
Fourteen institutions publish a Loan To Deposit ratio as part of their reporting on refinancing through deposits. This ratio is used to assess an institution's dependence on the markets to ensure the financing of its business. The ratio is calculated as follows:

$$\text{"Loan To Deposit" Ratio} = \frac{\text{Amount of loans issued}}{\text{Amount of deposits taken}}$$

Where the ratio exceeds 100%, the bank does not hold sufficient resources in the form of deposits to finance the loans it has issued. Apart from the use of capital and reserves, it is forced to seek some of its refinancing in the markets.

Of the 14 institutions which reported on this concept, the average published ratio is 115%.

Analysis of financial reporting

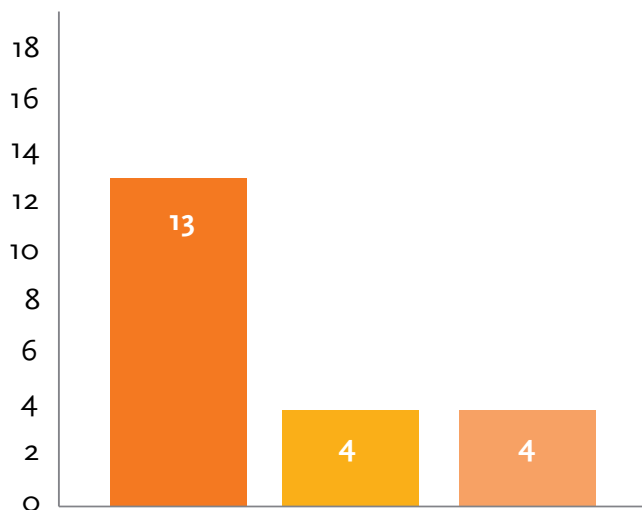


On average, 15% of the refinancing of European credit institutions in order to make loans must be obtained in the markets. Significant differences exist in the sample studied, the ratios going from 74% to 164%, reflecting heavily market-dependent refinancing in the case of the Bank of Ireland.

Refinancing through the market

Refinancing through the market represents the major source of refinancing for the European universal banking model. Banks mainly provide information on the structure of refinancing, asset reserves, their refinancing programmes and foreign currency refinancing. Their reporting on each of these topics is very uneven.

● Structure of medium and long-term refinancing



Reporting on the structure of medium and long-term refinancing at Q3-11 (in number of banks)

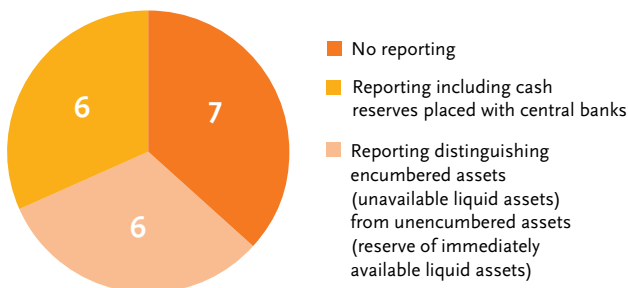
- No reporting
- Reporting on the nature of refinancing (secured or unsecured)
- Reporting on the type of instruments used (covered bonds, securitizations, senior unsecured, LT Repos etc.)

Only six institutions publish information on the nature of their refinancing (on average 40% unsecured and 60% secured) or on the type of instruments used (covered bonds, securitizations, senior unsecured, LT Repos, etc.), while two banks report on both the nature of refinancing and the type of instruments.

Analysis of financial reporting

• Asset reserves

Reporting on asset reserves at Q3-2011



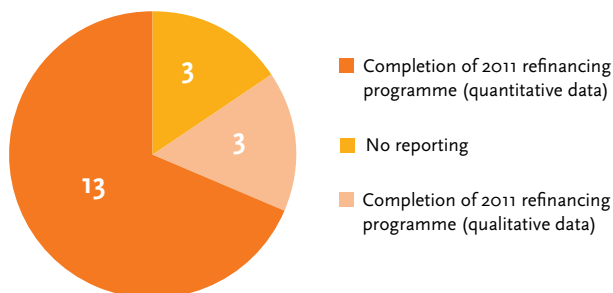
Asset reserves generally correspond to:

- > Liquid assets which are unavailable, or “encumbered assets”;
- > Liquid assets which are available immediately, or “unencumbered assets”;
- > Deposits with central banks

The financial reporting of the banks in the sample is not consistent. Of the two-thirds of these institutions which published the data at 30 September 2011, some included central bank deposits in their reports and others only mentioned the concept of assets accepted by central banks.

• Refinancing programmes

Reporting on medium and long-term refinancing programmes at Q3-2011



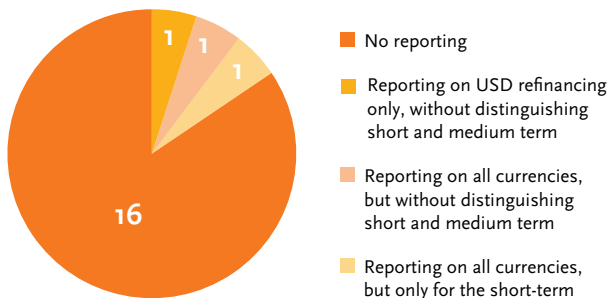
At 30 September 2011, 80% of the benchmark banks reported on their medium and long-term refinancing programmes and confirmed the completion of the 2011 programmes. Five announced that they were bringing forward their 2012 medium and long-term refinancing programmes, after seizing windows of opportunity in the markets at the end of 2011.

However, there is only little detailed information available regarding the completion of financing programmes:

- > 20% publish no quantified data;
- > 80% report on the total amount of their 2011 programme. For the 13 banks concerned, the total average amount of medium and long-term refinancing programmes carried out in 2011 is some €30 billion. Some banks also publish detailed information such as average issue maturity (average of 6 years for the four institutions concerned) or the average spread (two institutions).

● Foreign currency refinancing

Reporting on foreign currency refinancing at Q3-2011



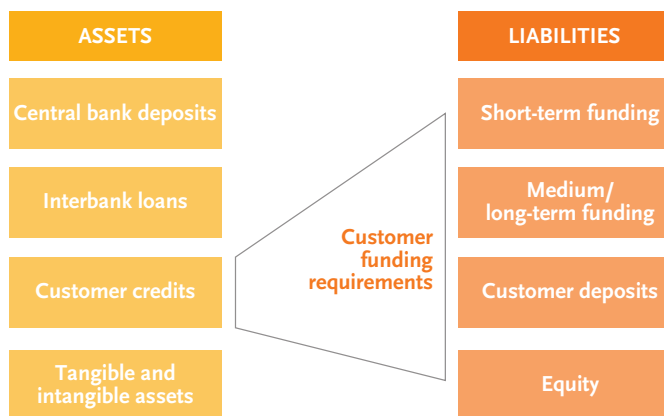
Analysis of financial reporting

The majority of institutions provide no quantified data on their foreign currency refinancing, whereas the topic is widely addressed in qualitative terms. The three establishments publishing quantitative data do so in a heterogeneous manner:

- > Reporting based on refinancing in USD;
- > Reporting only presenting the short-term;
- > Reporting that fails to distinguish between the short and the long term.

The introduction of the LCR, expected at the start of 2013, should significantly strengthen reporting on currency refinancing programmes.

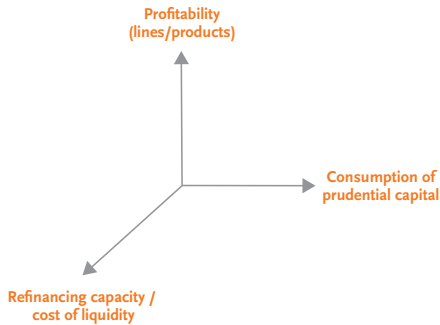
An analysis of the financial reporting of banks throughout 2011 reveals a significant increase in disclosures on liquidity, six institutions in our sample even publishing a 'liquidity statement' at 30 September.



However, the data is varied. Whereas reporting focuses on Retail business in order to attract deposits, the data are, again, not very detailed for Wholesale refinancing. Few institutions explain their refinancing structure, the different currencies, or the maturity and spread of instruments used. Communication regarding the introduction of Basel III measures is still lacking, not least in terms of the impact on the banks' activities.

However, the present liquidity crisis, in particular where currency-related, as for the USD refinancing of European banks, and the forthcoming introduction of Basel III measures in Europe, should lead institutions to increase their financial reporting on this topic. As from 2015, the introduction of the LCR will cause the banks to provide more detailed and regular disclosures on short-term liquidity to regulators.

The Basel III liquidity measures and their transposition into European law (although certain aspects are yet to be settled) seem likely to change banking conditions and the strategies of banks to a significant degree. Thus, the management of banks will in the future need 3D vision to ensure that all the



lines/products marketed provide a level of profitability which is acceptable to shareholders while meeting the prudential requirements in terms of capital and reserves and while ensuring that the bank is in a position to withstand very severe liquidity crises (in all the currencies in which it operates) in order to refinance while controlling the associated costs.

Thus, the majority of credit

institutions must conduct:

- An analysis of Basel III measures (profitability/capital and reserves/liquidity) for their business lines, and consider whether they should dispose of or restructure activities outside their core business;
- A verification of their liquidity management policy, their governance and the models existing to be in phase with the local good practice;
- A review of their information systems in order to:
 - > ensure their capacity to convey the information required by the regulator;
 - > to carry out any IT developments necessary to reach the required quality level;
- An identification of resource needs in terms of information systems, in order to develop future regulatory reporting and other reports on liquidity which will be requested more often;
- An examination of the various constituents of Basel III measures in order to take decisions (concept of 'very liquid', capital flight scenario, stable funding criterion, etc.)

We can already observe a number of measures which have been taken by European credit institutions to ensure conformity with the Basel III liquidity requirements:

- The race to the take deposits to the detriment of life insurance products in Europe (to meet the constraints of the NSFR);
- The anticipation of 2012 medium and long-term refinancing programmes, with the seizing of windows of opportunity in the markets at the end of 2011;
- The reduction in the size of balance sheets which is used to reduce the need for refinancing, not least the cessation of some business lines where institutions experience difficulties in refinancing (notably the financing of projects in USD);
- Ending the financing of some long-term activities which would in very costly in terms of liquidity, in the light of the NSFR (including loans to local authorities).

These measures are only the first of a long series of Basel III measures that will bring about in-depth changes in the business model of European credit institutions.

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