

EXPLANATORY NOTES
on the announcement
of the amendment of the Principles concerning the
Own Funds and Liquidity of Institutions
of November 25, 1998

I. General Notes

The reason for the amendment of the Liquidity Principle is the rebasing of the accounting method on residual maturities from the financial year which begins after December 31, 1997. The Liquidity Principles II and III, which were based on the concept of original maturities, are being replaced by a new Liquidity Principle, which the Federal Banking Supervisory Office will use to assess the liquidity of an institution on the basis of the liquidity-relevant assets and liabilities classified by residual maturities. The new Liquidity Principle will be called "Principle II".

The former Liquidity Principles have been amended for the following reasons:

- Owing to the changeover in the classification on the balance sheet from originally agreed maturity dates or notice period to residual maturities in the financial statements for financial years beginning after December 31, 1997 (see § 39 (4) of the Ordinance Regarding the Accounting System for Banks (*Verordnung über die Rechnungslegung der Kreditinstitute* or *RechKredV*)), the concept based on original maturities applied in Principles II and III becomes invalid. Since the percentage weights of the asset and liability items of Principles II and III, which indicate the corresponding degrees of liquidity, were determined on the basis of original maturities, the statistical basis for calculating Principles II and III became inapplicable owing to the accounting method being rebased on the residual maturity.
- In accordance with section 11 of the Banking Act, which has been amended as a result of the Sixth Amendment of the Banking Act, the liquidity provision shall also apply to financial services

institutions. There was need for action since Principles II and III had been geared to the requirements of a typical universal bank.

- Principles II and III could no longer bear comparison with international liquidity standards, which are based on residual maturities.
- The amendment of the Liquidity Principles is now an overdue response to changes in credit institutions' business operations and restructuring within the banking industry which have taken place over the past 25 years.

An essential feature of the new Principle II is that the liquid assets available to the institution over the following 12 months and the actual and potential liquidity outflows are listed in a maturity grid subdivided into four time bands. The institution's liquidity situation is to be assessed on the basis of a liquidity ratio (one-month ratio), which is to be reported each month and which is calculated as the ratio of the liquid assets to the liquidity outflows during the month following the reporting date (ex ante analysis). The institution's liquidity is, as a rule, considered to be adequate if the liquidity ratio is equal to or greater than 1. The due amounts of the assets and liabilities with fixed remaining terms are allocated to the time-band-based liquidity recording scheme according to their residual maturities or remaining notice periods. For reasons of simplification, liabilities unlimited in time and legally binding lending commitments are included at certain weights solely in the first time band. Outpayments for which the outpayment dates and the amounts of the individual tranches are not fixed are only included if they affect the liquidity outflows to be expected in the month to come (= first time band).

In addition to the one-month ratio, additional observation ratios are to be calculated as memo items to assess the liquidity for the following 11 months. The eligible liquid assets primarily include those assets which can be assumed to be capable of being sold under all market conditions without any losses in value (tier-1 liquidity). In addition, those balance sheet assets with fixed remaining terms are assigned to the liquid assets that fall due during the reference period. Where the maturity of the assets is not fixed (for example in the case of credit lines for an unlimited period), the liquidity items are to have certain weights applied to them which reflect the average residual lock-in period of those assets.

The one-month-ratio of Principle II is, as a rule, used to assess whether the liquidity of the institution is adequate. The new liquidity recording scheme is based on the premise that a solvent, profitable institution is usually not faced with insurmountable obstacles to ensuring medium and long-term funding, which may, if necessary, also take the form of additional interbank borrowing and/or extraordinary sales of securities. Short-term funding is to be regarded as more problematic than medium and long-term funding. Over the short term, even solvent and profitable institutions may face the risk of liquidity shortages since unexpected incidents and unforeseen market conditions can put greater-than-usual strains on individual institutions' liquidity. The time span of one calendar month is deemed to be a critical

time horizon. However, periods exceeding one month and up to one year are also relevant to banking supervision as liquidity problems that may occur over that period of time may point to funding problems which are due to structural factors. For this reason, the liquidity recording scheme of the new Principle II covers a total period of up to twelve months. Data on liquidity relating to periods between one month and one year are memo items only.

An institution faces a refunding risk if its funding is not unreservedly guaranteed because resources available over the short term have been used for longer-term asset-side business (maturity transformation). Principles II and III were disproportionately biased towards restricting the funding risk. Under the "old" Principle II a credit institution's investments in assets locked in over the long term and which could not be easily transformed into liquidity were not allowed to exceed the institution's long-term financial resources. Principle III stipulated that investments locked in over the medium and shorter term must not exceed the medium and short-term financial resources including potential financial surplus arising from Principle II. However, there are other (original) liquidity risks besides the funding risk: in particular, there is the time risk (untimely redemption and/or interest payments) and the withdrawal risk (unexpected utilisation of credit lines and other committed lending or unforeseen withdrawal of deposits by creditors). The new Liquidity Principle has been designed to take account of the withdrawal risk, too.

The methodology applied to the revised version of Principle II follows the approach on which the trial calculation for an EU liquidity ratio are based. However, there are the following specific differences:

- Eligible asset and liability items: the classification and definition of the eligible asset and liability-side liquidity items have been revised and brought more closely into line with the accounting provisions of the Ordinance Regarding the Accounting System for Banks (*RechKredV*).
- Classification of the maturities: the time bands of the EU trial calculations have been retained with the following changes: the time band of "due on demand and up to twelve months" has been deleted because it does not provide any essential additional information. This time band was used solely for memo item purposes.
- Assessment of the items regarded as highly liquid assets: the criteria specifying whether financial assets held in the portfolio (primarily securities) may be regarded as being readily convertible into liquidity at all prevailing market conditions have been reviewed and amended with regard to the EU trial calculations. Securities are always recorded according to current market prices, not according to predefined book values adjusted for various issuer-specific discounts, as was previously the case.
- Weights for liquidity items of indeterminate (residual) maturity: owing to suggestions made by the banking industry, some of the weights used in the EU trial survey have been changed in order to adapt them to the conditions prevailing in the Federal Republic of Germany.
- The calculation of an overall ratio has been completely eliminated.

The conditions of European Monetary Union, in force from January 1, 1999, have been taken into account in formulating Principle II. On that date, the transition to stage 3 of Economic and Monetary Union will become effective and a single currency (the euro) will be launched. The European System of Central Banks (**ESCB**), consisting of the European Central Bank (**ECB**) and the national central banks of the EU member states, will be responsible for the single monetary policy. To implement the single monetary policy the ESCB will use monetary policy instruments in the form of open market operations and standing facilities. The Bundesbank will in future conduct the liquidity-providing open-market operations (time transactions) as collateralised loans. This is also true for liquidity provided to institutions through the marginal lending facility.

Liquidity provided to institutions through refinancing operations with the Bundesbank is recorded as additional liquid assets in the first time band of Principle II. The liquidity inflow is set against a liability, the amount and maturity of which correspond to the refinancing operation and which is to be recorded as a payment obligation.

The way in which liquidity inflows resulting from refinancing operations with the Bundesbank are recorded does not depend on the underlying pledged assets because the collateralisation of the refinancing operations will, in future, exclusively take the form of pledging, with the eligible collateral being added to a pool by the Bundesbank. For the purposes of Principle II, the underlying assets in the pool shall be subject to the general weighting principles. Since the pledging is general, i.e. not linked to the individual refinancing operation, it is not possible to earmark each identifiable security, each identifiable loan claim and each eligible bill of exchange as actually underlying a specific refinancing operation.

II. Amendment of Principle II

§ 1

Scope

Section 1 describes the scope of the new Principle II and also specifies which institutions have to apply Principle II. Furthermore, section 1 provides the basis for taking into account positive or negative special circumstances obtaining at an institution whose liquidity does not meet the general requirements owing to particular structural features. The relevant provisions concerning how the Liquidity Principles are to be applied were formerly included in the Preamble of the Principles concerning the Own Funds and Liquidity of Institutions. With the amendment of the Liquidity Principles, the plans to delete the Preamble of the Principles concerning the Own Funds and Liquidity of Institutions, which have existed for quite some time now, are now being implemented (see the "Explanatory Notes" on Principle I of October 29, 1997 - I 7 - A 223 - 2/93, page 9 [note: the page number refers to the German version of Principle I pending the

appearance of an English translation]). The structure and wording of the provision of section 1 with regard to the scope of application of Principle II are based on the analogous provision of Principle I.

Subsection 1 specifies the contents of Principle II. Sentence 1 refers to section 11 sentence 2 clause 1 of the Banking Act, which stipulates that the Federal Banking Supervisory Office (acting in agreement with the Deutsche Bundesbank) draws up Principles whereby it assesses, as a rule, whether the liquidity of an institution is adequate.

The wording of sentence 2 is based on section 1 (1) sentence 2 of Principle I. However, unlike the analogous provision of Principle I, sentence 2 addresses only institutions, since section 11 does not apply to groups of credit institutions, groups of financial services institutions or groups of financial holdings. In the case of both Principle I and Principle II there is normally reason to suppose that the requirements of the Banking Act concerning the institution's own funds or liquidity are not met if the institution fails to meet the requirements laid down in the Principles by more than an insignificant amount, or repeatedly. In accordance with sentence 2 it must, as a rule, be assumed that in the case of a more-than-insignificant or repeated non-compliance with the minimum requirements, stipulated in section 2 (1) and to be calculated in accordance with section 2 (2), the liquidity of an institution is not adequate.

Sentence 3 mentions exceptional cases in which the Federal Banking Supervisory Office may take into account positive or adverse special circumstances obtaining at an institution which, depending on the situation, may warrant lower or higher requirements in Principle II. The possibility of taking into account positive or adverse special circumstances ensures the "flexibility" which Parliament has considered necessary for the implementation of the principles under sections 10 and 11 of the Banking Act (see the substantiation of the Banking Act Bill, General Notes, section VI.1; BT-Drs. III/1114). In line with the practice hitherto, the institution will probably regularly make an application to the Federal Banking Supervisory Office before positive special circumstances are taken into account. Usually, no positive special circumstances obtaining at an institution are not taken into account if the institution meets the requirements of the Principle. The way in which lower or higher requirements are made when special circumstances are taken into account is to be decided in each case in accordance with the pertaining conditions. In certain cases, it would probably be the obvious thing to do to include additional asset or liability items in the calculation of the liquidity ratio. In other cases, lower or higher requirements might consist in specifying other weights for individual asset or liability items. In contrast to Principle I (see section 1 (5)), the inclusion of positive special circumstances is not confined to certain categories of banks or to specific areas of regulation. There are no EC provisions which make such restrictions an absolute imperative.

Subsection (2) defines the scope of Principle II by specifying certain institutions to which the Principle does not apply. Subsection 1 qualifies sentence 1 of subsection 1, which stipulates that Principle II has to be calculated by those institutions to which section 11 of the Banking Act applies. These are

- credit institutions (including domestic branches of enterprises domiciled abroad within the meaning of section 53 of the Banking Act) which conduct banking business in accordance with section 1 (1) sentence 2 of the Banking Act
- financial services institutions (including domestic branches of enterprises domiciled abroad within the meaning of section 53 of the Banking Act) which provide financial services in accordance with section 1 (1a) sentence 2 of the Banking Act
- domestic branches of enterprises domiciled in another state of the European Economic Area (section 53b (1) sentence 1 and (7) sentence 1 of the Banking Act).

The application of the liquidity provision of section 11 of the Banking Act to financial services institutions results from the fact that following the Sixth Amendment of the Banking Act the provisions of the Banking Act also apply to financial services institutions. The reason cited for the inclusion of financial services institutions in section 11 of the Banking Act was that financial services institutions, holding customers' funds and securities, or simultaneously trading on stock and OTC markets for their own account, are subject to specific liquidity-related risks and thus need to maintain adequate liquidity (see Substantiation of the Sixth Amendment of the Banking Act of June 17, 1996, Special Part, Number 12 to section 11; in: BR-Drs. 963/96, right-hand column).

Principle II does not apply to certain institutions, which are enumerated in subsection 2 because special legal provisions give reason to assume that these institutions possess adequate liquidity. This applies to investment companies, to which risk diversification provisions are in force in accordance with the Act on Investment Companies (**no 1**). Housing enterprises with savings schemes still need to calculate the end-of-quarter liquidity status geared to their needs and the end-of-year financial status (see announcement I 3 - 1126 - 1/63 of September 27, 1990; published in CMBS under number 4.58c [note: CMBS = Cronsbruch (C), Möller (M), Behre (B), Schneider (S) is a compendium of the German Banking Act and other supervisory rules regarding banks]). Principle II therefore does not apply to housing enterprises with savings schemes (**no. 2**).

In accordance with **no. 3** Principle II only applies to financial services institutions which conduct trading for their own account (section 1 (1a) sentence 2 number 4 of the Banking Act), or which are authorised as investment brokers (section 1 (1a) sentence 2 number 1 of the Banking Act), contract brokers (section 1 (1a) sentence 2 number 2 of the Banking Act) or portfolio managers (section 1 (1a) sentence 2 number 3 of the Banking Act) to obtain the ownership or possession of funds or securities of customers, or which trade in financial instruments for their own account. These are the same financial services institutions to which Principle I applies. Principle II does not apply to other financial services institutions because they are much less subject to liquidity risks which might affect business relationships with their customers. This includes those financial services institutions whose business activity is confined exclusively to taking on the role of a broker. In acting purely as a broker, the risk of an unexpected

withdrawal of liquidity, which Principle II aims to restrict, is, as a rule, of minor significance. To that extent, this exemption from Principle II is therefore justified.

Section 2

Proof of adequate liquidity

In accordance with section 11 of the Banking Act institutions must invest their funds in such a way as to ensure that adequate liquidity for payment purposes is guaranteed at all times. The requirement of adequate liquidity is specified in section 2. Institutions are required to maintain an adequate amount of liquid assets to meet their short-term payment obligations. The liquid assets are deemed to be adequate if there is excess liquidity, i. e. if the available liquid assets cover or exceed the payment obligations callable at short notice. A time-based liquidity recording scheme consisting of four time bands is used to determine the payment obligations that are likely to be called at short notice. The underlying maturity breakdown is based on the internationally accepted standard. The short-term payment obligations to be included in the liquidity recording scheme include both liability items due on demand callable daily either in part or in their entirety and liabilities with a residual maturity or agreed period of notice of up to one year, as well as off-balance sheet commitments. Liquid assets include primarily asset items which provide immediate liquidity or which can easily be converted into liquidity, and other assets and securities (including money market paper of non-public issuers) due within one year. The residual maturity is calculated as the period between the current reporting date and the due date of the respective balance sheet item. Section 7 specifies what period of time is deemed to be the residual maturity.

In order to prove that the institution maintains adequate liquid assets to meet its payment obligations in the calendar month following the reporting date it has to calculate a liquidity ratio that expresses the liquid assets included in the first time band as a proportion of the payment obligations callable during this period. The institution's liquidity is deemed to be adequate if the liquidity ratio does not fall below the value of 1. In addition, the institution has to calculate and report observation ratios as memo items concerning the liquidity conditions in the second, third and fourth time band. In doing so, excess liquidity from the preceding time band shall be considered as additional liquid assets in the following time band.

Subsection 1 requires that institutions, as a general rule, must maintain an adequate amount of liquidity in order to be able to meet their payment obligations easily. The fulfilment of the payment obligations must not affect current business ("going concern" assumption). Consequently, an adequate liquidity buffer must be ensured at all times. The requirement of section 1 is based on section 11 of the Banking Act, whereby institutions have to invest their funds in such a way as to ensure that adequate liquidity is guaranteed at all times. Whether the liquidity is adequate is assessed on the basis of a recording scheme consisting of four time bands:

1. due on demand up to one month,

2. over one month and up to three months,
3. over three months and up to six months,
4. over six months and up to twelve months.

The breakdown into the above-mentioned time bands, which deviates from the maturity breakdown specified in § 9 (2) of the *RechKredV*, largely follows the underlying methodology of the EU trial calculations.

In accordance with subsection 2 sentence 1 the Federal Banking Supervisory Office uses a liquidity ratio, which is to be calculated by the institution at the end of each month, as a basis for assessing whether the liquidity of the institution is adequate. In the following sentence (sentence 2) the liquidity ratio is defined as the proportion of eligible liquid assets to payment obligations included in the first time band. The wording (*the* liquidity ratio rather than *a* liquidity ratio) already suggests that the liquidity ratio must be calculated on the basis of predefined steps. This ensures that the assessment of an institution's liquidity is based, as hitherto, on an objective, universally valid benchmark. In addition, the liquidity ratio continues to be calculated and reported on a monthly basis.

For the purposes of allocating the items which constitute the liquid assets and the short-term payment obligations, a distinction is made between two categories in case. Firstly, the liquid assets relevant to Principle II include components which can be regarded as items that can easily be converted into liquidity at all prevailing market conditions, irrespective of their legal (residual) maturities. These items must be recorded in the first time band. They are assets which may generally be assumed to be convertible into tier-1 liquidity. These assets are listed in section 3 (1), along with cash and balances with central banks. Secondly, there are also items due within the next twelve months which result in incoming payments at the institution. These items must be entered into the liquidity recording scheme according to their respective residual maturities. Only those asset items for which incoming payments are considered to be secure are included. Currently non-performing loans to which individual value adjustments have therefore been made are not taken into account. The list of the liquidity assets has been designed in such a way as to include only those assets which unquestionably generate liquidity inflows within the specified time bands.

The payment obligations include, firstly, obligations callable by other institutions or the institution's customers which can lead to immediate outpayments. They not only include liabilities due on demand but also obligations without a due date and contingent liabilities which are likely to be withdrawn, at least in part, during the duration of the first time band. The inclusion of such obligations aims to limit the (passive) withdrawal risk, i. e. the risk that deposits and other funds held by the institution are unexpectedly called prematurely or that the institution's payment obligations is unexpectedly utilised. With respect to the objective of Principle II of limiting the withdrawal risk, it would be insufficient if the call

rates arising from the aforementioned obligations only reflected the average level of experience figures observed over the longer term. Rather, it was necessary to include a buffer when specifying the call rates in order to take account of varying utilisation.

Secondly, the short-term payment obligations arising from the liabilities due within the next twelve months are to be included. Owing to the fixed maturities or periods of notice these funds cannot be called prematurely. Thus the dates and amounts of the due payments are fixed. The payments are to be allocated to the four time bands of the liquidity recording scheme according to the residual maturities of the above-mentioned liabilities (for more details see section 4).

Sentence 3 specifies the requirements that must be fulfilled in order for the liquidity of an institution to be considered adequate. The liquidity is deemed to be adequate if the liquid assets available to the institution in the next (calendar) month at least cover the payment obligations of the institution during that month, i. e. if its liquidity ratio does not fall below one. In other words, there must not be a deficit in one-month liquidity. Sentence 3 contains the key requirement of the Liquidity Principle. On the basis of the liquidity ratio the Federal Banking Supervisory Office will, as a rule, assess whether the liquidity of an institution is adequate (section 1 (1) sentence 1). The values of the liquidity ratio in accordance with sentence 3 are used by the Federal Banking Supervisory Office to decide whether measures in cases of inadequate liquidity (section 45 (1) sentence 1 number 2 of the Banking Act) are to be ordered. If the monthly available liquid assets fall below the monthly callable payment obligations repeatedly or by more than an insignificant amount, there is reason to suppose that the liquidity of the institution is not adequate. The Federal Banking Supervisory Office will request the institution to improve its liquidity situation and to meet the requirements of Principle II. Principle II must be calculated – and its requirements must be met – at the end of each month. The aim of this restriction to the conditions prevailing at the end of the month is to keep the technical and organisational work-related efforts necessary for calculating Principle II at an acceptable level. However, above and beyond the monthly requirement, banking supervisors expect the institutions' liquidity to be adequate during the periods between the reporting dates as well. If an institution gives reason to suppose that its liquidity is not adequate between the reporting dates, the Federal Banking Supervisory Office will examine whether the institution is intentionally abusing the provisions laid down in subsection (2) sentence 1. It will take adequate measures to rectify the situation as necessary.

Pursuant to subsection 3 the institution has to calculate observation ratios in addition to the liquidity ratio. The observation ratios give the liquidity situation in the three time bands covering the period between one month and 12 months (over one month and up to three months, over three months and up to six months, over six months and up to 12 months). The observation ratios pursuant to sentence 1 serve as memo items only. There are no specified minimum values to be met. The observation ratios help Banking Supervision assess whether there is any maturity transformation in the short-term range at the institution.

Observation ratios lower than one indicate that funds accepted over the short term have been invested over the longer term. Principle II judges that this does not constitute an acute withdrawal risk as long as the one-month liquidity ratio is greater than one. For the sake of clarity, sentence 2 explicitly states that the observation ratios are calculated in the same way as the liquidity ratio. When calculating the observation ratio, any excess liquidity in the previous time band is to be included as additional liquid assets in the following time band (sentence 3). This excess provision takes account of the consideration that liquid assets not committed to short-term payment obligations can be used without restriction for the settlement of longer-term payment obligations. Assets that form part of the liquidity reserve can generally be assumed to be convertible into tier-1 liquidity (cash or balances with central banks) at a later date and are thus available as potential liquid assets for settling payment obligations which become due at a later point in time.

Section 3

Liquid assets

Section 3 enumerates the items deemed to be liquid assets within the meaning of Principle II. Unless otherwise indicated, the definitions of the *RechKredV* apply. Eligible liquid assets include those liquidity components which can be regarded as being easily convertible into liquidity at all prevailing market conditions, irrespective of the contractual (residual) maturities (tier-1 liquidity). As a rule, these liquidity components are to be recorded in the first time band. Secondly, there are assets due within the following twelve months which result in liquid asset inflows at the institution. These items are to be allocated to the four time bands according to their residual maturities (tier-2 liquidity). Under this classification, subsection (1) lists the liquidity components including cash, balances with central banks and paper for collection. Subsection (2) lists the assets whose residual maturities do not exceed twelve months. Subsection 3 lists the assets that are not to be included as they are neither due within the following twelve months nor deemed to form part of tier-1 liquidity. In order to avoid potential misinterpretations and any incorrect inclusion of assets, explicit reference is made to those assets that must not be included in the liquidity recording scheme.

Subsection 1 lists the tier-1 liquidity items which must be allocated to the first time band irrespective of their particular residual maturities. Firstly, the assets that form central bank money are mentioned. These include cash (**no. 1**) and balances with central banks (**no. 2**), which together are to be shown as "liquid funds" in the balance sheet (asset item 1 of form 1 of the *RechKredV*, see section 12 of the *RechKredV*). "Balances with central banks" (**no. 2**) are assets due on demand, which the institutions can use at all times. The utilisation of a deposit facility, i. e. the possibility of depositing "overnight" money with the Bundesbank, the ECB and other national central banks of the ESCB, must not be shown here; instead, it must be included in loans and advances to the ESCB due on demand (see section 3 (2) 1). There is also paper for collection (**no. 3**). This includes cheques and other paper for collection, provided that it is due for submission within 30 days of presentation and has already been

credited to the presenter (see section 20 of the *RechKredV*). In addition, it includes matured debt securities and interest and profit-sharing coupons, which are shown under asset item no. 15 of form 1 of the *RechKredV*. Option premiums paid on acquired options and non-securitised, non-repayable preference coupons are not to be included.

The assets listed in numbers 4 to 7 are liquidity items that can easily be mobilised, i. e. it is assumed that these items can generally be converted into tier-1 liquidity within a very short period of time and are thus readily available as liquid assets for settling the payment obligations due and callable in the first time band. Irrevocable lending commitments received by the institutions (**no. 4**) include formal and legally binding commitments, provided that the requirements for using the committed funds are met and the funds can be called immediately. Lending commitments where the disbursement of the resources is subject to conditions that are not met on the reporting date are not included. Lending commitments where the preconditions for disbursement are currently not met but will be fulfilled in the course of the following twelve months are likewise not included. Facilities available in the context of money market dealing are not deemed to be binding obligations and are therefore not included. Facilities where the disbursement of the lending commitments is not ensured owing to the lack of a binding agreement do not provide any reliable inflows of liquidity. For this reason, such facilities were not put on the same footing as the irrevocable lending commitments. For the purposes of Principle II it is acceptable to include only credit lines which can unquestionably be converted into liquidity on the institution's initiative. Refinancing facilities granted to the institution by the parent company or an associated company belonging to the same group within the context of intra-group funding may be included as asset items, provided that they are legally enforceable. The same holds true for irrevocable lending commitments within a group of institutions or a financial holding company group (intra-group commitments). Refinancing facilities granted by superordinate institutions within the context of a liquidity association (savings banks and credit cooperatives) are to be included only if they are likewise legally binding. This does not apply to eligible assets pledged to the Bundesbank under collateral pooling agreements.

No. 5 enumerates listed securities including listed money market paper which are deemed to be highly liquid assets and thus, so to speak, as tier-1 liquidity. These also include equalisation claims on the Currency Conversion Equalisation Fund converted into bearer debt securities at the creditor's request (section 8 (2) of the regulation on the confirmation of the conversion calculation method and the procedure for allocating and purchasing equalisation claims (BUZAV = "Verordnung über die Bestätigung der Umstellungsrechnung und des Verfahrens der Zuteilung und des Erwerbs von Ausgleichsforderungen"). The definition of "securities" under section 7 of the *RechKredV* applies. The main reason why these securities are counted as tier-1 liquidity is that they can be readily transformed into tier-1 liquidity without any significant losses in value.

Whether securities are deemed to be tier-1 liquidity depends on the conditions listed below concerning the paper's fungibility, its marketability and valuation. First of all, the classification of securities as liquidity presupposes that the securities are valued according to the strict principle of the lower of cost or market (section 253 (3) of the German Commercial Code), i. e. that they are valued as current assets. This means that apart from securities held in the trading portfolio (section 340c (1) of the German

Commercial Code) and the contingency (or liquidity) reserves (section 340f (1) of the German Commercial Code), only paper that is held as financial fixed assets and valued according to the strict principle of the lower of cost or market can be considered. By valuing securities as financial fixed assets on its balance sheet, an institution signals that it intends to hold these securities over the long term and that they are therefore not fully available as liquid assets (see the memorandum 17 - 4215 - 1/91 of March 19, 1993, published in CMBS as no. 17.27). For this reason, it is not acceptable to include securities which are valued in this way. By contrast, securities which are treated as valuation units together with matching interest rate swap agreements or other interest rate hedging transactions, and which are thus not subject to the valuation principles applying to financial fixed assets, must be assessed in a different way.

Securities valued at current market prices are fully eligible as liquid assets. The actual amount of liquidity from these securities depends on the current market situation. For the purposes of Principle II, the market prices as at the respective reporting date are relevant. However, institutions that count the securities towards the liquid assets at market prices are expected to value the securities at market prices on each trading day and not just on the reporting dates. This is because, in order to capture as precisely as possible the liquid assets available for fulfilling the payment obligations, the institutions must be aware at all times of the current value of their liquidity reserves. This is an indispensable precondition for an institution's liquidity management to be effective.

A further criterion for securities to be included in tier-1 liquidity –in addition to the fact that they must be valued at current market prices – is marketability. Only paper which is fungible and traded on recognised markets in a sufficiently high volume can reasonably be assumed to be fully and readily convertible into liquidity. This criterion is met primarily by listed securities. In the context of Principle II, listed securities are securities admitted for trading on a regulated market within the meaning of article 1 (13) of the Investment Services Directive in a member state of the European Union, in a state which is a party to the Treaty on the European Economic Area, or on a recognised stock exchange within the meaning of section 1 (3e) of the Banking Act in non-European zone A states. For the list of regulated markets and the recognised stock exchange of another zone A country see the "Explanatory Notes" 17 – A 223 - 2/93 of October 29, 1997 on section 23 (3) of Principle I (pages 125 – 129 [note: the page number refers to the German version of Principle I pending the appearance of an English translation]). The definition is narrower than the definition of listed securities according to section 7 (3) of the *RechKredV*. Under the disclosure requirements, securities quoted on a German stock exchange for first segment trading or a regulated market and securities listed or traded on a foreign exchange market are considered to be quoted on a stock exchange. The restriction to regulated markets of the European Economic Area and recognised stock exchanges of another zone A country made by Principle II is designed to ensure that only paper traded on liquid markets is included under liquid assets. In the case of stock exchanges other than those mentioned above, it cannot necessarily be assumed that there is sufficient liquidity.

Listed securities transferred to the institution as a transferee or borrower are to be counted as available liquidity, irrespective of how they are recorded on the balance sheet. It is possible for the institution to

convert into cash the securities transferred to it under repurchase or lending agreements or to use them in another way to obtain tier-1 liquidity. Since the transferee is only obliged to retransfer securities of the same kind and quality (obligation in kind), he is largely free to use them as he pleases in the meantime. In order for the transferred securities to be included in the transferee's or borrower's liquidity the transferee or borrower must value them at current market prices. Repurchase and lending agreements referring to paper other than listed securities and other assets are given a zero weighting.

In addition, tier-1 liquidity includes debt securities which fulfil the requirements of article 22 (4) sentences 1 and 2 of the Undertaking for Collective Investment in Transferable Securities (UCITS) Directive (**no. 6**), irrespective of whether they are quoted on a stock exchange. Owing to the underlying covering funds, these securities are particularly secure and can be sold on the market at all times. No. 6 also includes own mortgage bonds held by the institution and/or communal bonds of the issuer. With respect to the capital change, the principles for listed securities in accordance with no. 5 apply. This means that the paper must be recorded at current market prices. If the market price is not available, the paper is to be counted at 90 per cent of its book value (see section 6 (1) sentence 3).

Shares in money market and securities funds which fall under the provisions of the Investment Companies Act (*Gesetz über Kapitalanlagegesellschaften* or *KAGG*) or the Foreign Investment Funds Act (*Auslandsinvestmentgesetz* or *AusllvestmG*) are weighted at 90 per cent of their respective repurchase prices, provided that the repurchase and settlement regulations applicable to German investment fund shares are observed (**no. 7**). Weighting the shares mentioned in no. 7 as liquid assets is justified because the securities and money market instruments underlying the special funds give reason to assume that the liquidity of shares essentially corresponds to the liquidity of the asset components of the special funds. In addition, the special statutory provisions of the *KAGG* and the *AusllvestmG* ensure that the investment fund share can be returned at any time at the share value calculated on every trading day. Furthermore, there are distribution and investment provisions stipulating that the special funds must consist overall of assets of high investment quality. Since, in accordance with section 8 (2) of the *KAGG* up to 10 per cent of the overall value of the special fund may be invested in unquoted securities and debt certificates, which, according to the evaluation of Principle II, are not counted as tier-1 liquidity, a mark-down of 10 per cent of the repurchase price has been set. The mark-down, which must be applied without exception, takes account of the fact that the aforementioned investment fund shares, on the one hand, and the underlying securities and money market instruments, on the other, are not identical and that the investment fund shares are thus a derived form of tier-1 liquidity. Investment fund shares for which compliance with the settlement provisions laid down in the *KAGG* or the *AusllvestmG* is not ensured, or for which the time allowed for settlement exceeds seven trading days, are not treated by Principle II as liquidity reserves which add to the institution's liquid assets, and should therefore not be taken into account. The aforementioned provision refers to both investment funds open to the general public and to specialised funds.

Subsection 2 lists the assets with residual maturities of up to one year. These are assets with agreed maturity dates or periods of notice which an institution, on the basis of legal agreements, may assume

to result in an inflow of liquid assets during the following year. They also include assets due on demand (see section 7 sentence 4). The assets listed in subsection 2 are to be included in the time bands of the liquidity recording scheme in accordance with their residual maturities.

Loans and advances to the ESCB (**no. 1**) include:

- receivables from the placing of fixed-term and fixed-rate time deposits with the Bundesbank, the ECB or other national central banks of the ESCB,
- the deposit facility open to the institution for making overnight deposits with the ESCB,
- receivables from the repurchase of foreign currency at a forward date under foreign exchange swap agreements with the ESCB; these receivables are to be included in the time bands according to the residual maturities of the relevant foreign exchange swaps,
- receivables from ESCB debt securities with the exception of bearer debt securities or order bonds,
- receivables from reverse transactions of the ESCB.

The distinction between loans and advances to credit institutions (**no. 2**) and loans and advances to customers (**no. 3**) is made on the basis of the concept of credit institutions as defined in Principle I (see the "Explanatory Notes" on Principle I | 5 - A 223 - 2/93 of October 29, 1997 regarding section 13, pages 59/60 [note: the page number refers to the German version of Principle I pending the appearance of an English translation]). Credit institutions are deemed to be credit institutions (section 1 (1) sentence 1 of the Banking Act) domiciled in the area in which the Banking Act applies, including the branches within the meaning of section 53 of the Banking Act. Credit institutions also include foreign credit institutions to which the definition of zone A credit institutions of the fourth indent of article 2 (1) of the Solvency Ratio Directive applies. This includes all credit institutions which have been granted authorisation in another EU member state or a state which is a party to the Treaty on the European Economic Area pursuant to the First Banking Directive including their branches in third countries as well as those credit institutions – including their branches - which have been granted authorisation in other zone A countries and to which the definition of credit institutions of the first indent of article 1 of the First Banking Directive applies. Financial services institutions (section 1 (1a) of the Banking Act) and investment firms within the meaning of article 1 number 2 of the Investment Services Directive are considered to be customers. This classification is irrelevant to the calculation of the available liquid assets because loans and advances to credit institutions and loans and advances to customers are treated equally in this respect. The institutions' loans to enterprises which have been pledged to the Bundesbank are likewise to be recorded here in accordance with their residual maturities.

The current account credits included in the items "loans and advances to credit institutions" (no. 2) and "loans and advances to customers" (no. 3) are to be assigned to the first time band, provided that they

do not have a due date. If they do have a due date, the period between the reporting date and the maturity of the credit is the criterion for their inclusion in the liquidity reporting scheme. Furthermore, receivables from leasing transactions are to be included in no. 2 or no. 3, including receivables from leasing transactions which a credit institution purchases à forfait from leasing companies at present value.

The bill portfolio is included in **no. 4**. However, bill-based loans which have already been included in loans and advances to credit institutions (no. 2) or to customers (no. 3) must not be included in no. 4. The asset item no. 4 mainly comprises bills rediscountable at the central bank.

The asset claims of the lending institution to the return of the securities lent (see the announcement I 4 - 212311 - 2/87 of August 25, 1987; published in CMBS, no. 17.18) are included in **no. 5**. On the balance sheet, these claims are recorded as receivables from credit institutions or receivables from customers. For the sake of clarity, these claims are mentioned separately in Principle II. At the time the claims become due, the institution receives an inflow of liquidity within the meaning of Principle II. Since only securities valued at current market prices with residual maturities of up to one year are considered to be fully convertible into liquidity under all market conditions, the inclusion of the asset claims of the lending institution is also subject to the condition that the underlying assets are valued at their current market prices (see also section 6 (1) sentence 1 number 4).

No. 6 includes securities other than the debt securities and other fixed-interest securities cited in subsection (1), provided that their residual maturities do not exceed one year. Notwithstanding the provisions of no. 6 and section 7 (1) sentence 1 number 1, securities acquired by the institution ex issue, i. e. as part of the original issue, are to be assigned to the time band determined by the date on which the securities were introduced into the market. No. 6 also includes money market paper with an original maturity of one year or less which are not recorded in subsection (1) number 5. This includes treasury bills, treasury certificates and similar public debt instruments with maturities of one year or less as well as other money market instruments such as commercial paper, euro notes, certificates of deposit, bons de caisse and similar claims evidenced by certificates.

In line with the treatment of due asset claims to the return of securities lent, claims against the transferee to the retransfer of securities transferred under securities lending transactions due within the next 12 months are calculated towards the liquid assets of the transferor (**no. 7**). This method, which differs from the accounting method applicable to genuine sale and repurchase agreements, takes account of the fact that the securities are actually available to the transferor, which is crucial from the point of view of liquidity. This principle likewise applies to paper pledged for collateralised loans.

Notwithstanding the accounting provisions, the transferee shall include a money claim against the transferor arising from sales with an option to repurchase in the amount to be repaid, provided that the current market value of the securities transferred is lower than the agreed amount to be repaid (**no. 8**). The money claim is to be included in the liquidity reporting system according to the date on which the

agreement ends. In the case of sale and repurchase agreements where no date has been specified, the first time band is relevant. The aforementioned money claim is included instead of the securities to be charged off in the event of the market price falling below the amount to be repaid (see section 5 (2) sentence 3). This is based on the evaluation that the transferee's right to retransfer to the transferor the securities transferred to him at the amount that has been agreed constitutes the same level of liquidity as a corresponding money claim against the transferor.

Additional liquidity inflows result from item **no. 9**, which, on the balance sheet, is shown as "compensation receivables from public bodies, including debt securities" (see §19 of the *RechKredV*). Where these are compensation receivables represented by listed securities, they are to be recorded in accordance with subsection 1 no. 5.

Subsection (3) explicitly mentions the assets which are not recognised as liquid assets. Although the exclusion of these assets is a logical consequence of subsections (1) and (2), they are listed separately for the sake of clarity. Firstly, loans and bills of exchange to which individual value adjustments have been made should not be included, provided they are currently non-performing (**no. 1**). As a rule, instalment credits are to be assumed to be currently non-performing if the debtor is in arrears by more than one instalment or if at least one reminder has been issued by the institution. Loans and bills of exchange to which value adjustments has been made but which are not currently non-performing are to be included in as subsection (2) as tier-2 liquidity in line with their residual maturities. Notwithstanding the value adjustments a liquidity inflow may be assumed, although it is reduced by the value adjustments (see section 6 (1) sentence 4). Where loans and bills of exchange are non-performing, there are no warranted payment rights. The unwarranted liquidity inflows should therefore not be included as liquid assets in Principle II. In addition, participating interests and shares in affiliated companies (**no.2**) are carved out because they do not have any fixed maturities or agreed periods of notice and therefore cannot be classified among the asset items of subsection (2). Moreover, uncollateralised own-debt securities which have been bought back (**no. 3**) are not counted towards the liquid assets. This is based on the consideration that an institution facing liquidity problems will probably find it difficult, or even impossible, to sell own-debt securities it has bought back in the market again and thereby obtain liquidity. This does not apply to own mortgage bonds and communal bonds in the institution's portfolio because – owing to the underlying cover funds – their saleability depends less on the selling institution's liquidity situation or financial soundness. Therefore, they are eligible liquid assets pursuant to subsection (1) number 6. Uncollateralised own-debt securities which have been bought back can be deducted from the outstanding liabilities. In addition, securities transferred under repurchase or lending agreements, for the duration of the agreement, are not part of the transferor's or lender's liquid assets (**no. 4**), irrespective of the way in which they are recorded on the balance sheet, because these instruments are not available to the transferor or lender. Instead, these instruments are counted towards the transferee or borrower. The reference to "for the duration of the agreement" makes it clear that these instruments are excluded solely for the duration of the sale and repurchase or lending agreement. The same consideration also applies to securities pledged as collateral (**no. 5**) unless they have been pledged with the ESCB or form part of the Bundesbank's other pool collateral. Although the securities are

still counted towards the assets of the provider of collateral, they are not available to him as reserves that can be converted into tier-1 liquidity. Securities that have been registered as a cover fund in the cover register and are not available to the collateral-providing institution because they have been earmarked for a special purpose, do not constitute eligible liquidity. During the period for which they constitute collateral, the liquidity of the provider of collateral is to be reduced by the corresponding amount. This means that, if listed securities are pledged as collateral for liabilities with residual maturities of, for example, five months, the securities cannot be entered in the third time band (over three months and up to six months); instead, they are counted towards the liquid assets belonging in fourth time band (over six months and up to twelve months).

Finally, investment fund shares other than those listed in subsection (1) number 7 do not count as liquid assets (**no. 6**).

Section 4

Liabilities

Section 4 enumerates the liabilities that are regarded as short-term liabilities within the meaning of Principle II. Unless indicated otherwise, the definitions and classifications laid down in the *RechKredV* apply accordingly. Subsection 1 enumerates the liabilities due on demand callable daily either partially or entirely. These liabilities have a (passive) withdrawal risk resulting from the uncertainty with regard to the outflows of liquidity that are to be expected in future. Although the institutions have gained experience with respect to the average withdrawal rates, it remains uncertain whether the institutions' liabilities will, in future periods, be drawn on to an uncommonly large extent. Furthermore, subsection 2 lists the liabilities with a residual maturities of up to one year that are to be recorded as liabilities in the liquidity recording scheme. Owing to their agreed maturity dates or periods of notice, these have only a limited withdrawal risk.

Subsection 1 lists the payment obligations that do not arise from liabilities with agreed maturity dates or periods of notice, i. e. liabilities and payment obligations an institution must expect to be called. The levels of the respective withdrawal risks are reflected by the rates with which the respective liability items are weighted.

As past experience has shown, liabilities due on demand to credit institutions (**no. 1**) generally have the highest withdrawal risk (see liability caption 1a of form 1 of the *RechKredV*). They are counted at 40 per cent of their book value towards the liabilities the institution must expect to be called during the course of the following month. By contrast, liabilities due on demand to clients (sub-caption ba) of liability caption 2 of form 1 of the *RechKredV* generally have a lower withdrawal risk; they are assigned a 10 per cent weighting (**no. 2**). Liabilities due on demand are limited to sight liabilities, i. e. liabilities the depositor can draw on at any time without previously giving notice. Call money until further notice

accepted as part of interbank transactions, and overnight money at daily notice is not recorded under number 1, but rather under subsection 2, number 2 instead.

The counting of savings deposits towards the liability components in the first time band (**no. 3**) is based on the observation that savings deposits are constantly being terminated and withdrawn. Owing to the large number of savers, it may be assumed, by way of an initial approximation, that the monthly calling rate will not change substantially from month to month. In other words, it may be assumed that the withdrawal risk pertaining to these deposits will remain broadly constant month-on-month. In this respect, it is appropriate to count that part of savings deposits towards the liabilities which must be expected to be called during the month following the reporting date. The remaining savings deposits are not taken into account. The liability components to be reported under **no. 3** include savings deposits with a period of notice of three months, which comprise by far the largest part of all savings deposits, as well as other savings deposits with a different period of notice.

Contingent (called-in) liabilities arising from endorsement liabilities and other bill-related contingent liabilities from charged and re-sold bills of exchange (see § 26 (1) of the *RechKredV*) are recorded under contingent liabilities from rediscounted bills (**no. 4**). Since their calling rates are generally low, these contingent liabilities are only counted at 5 per cent of their book value. Similar considerations apply to the recording of the withdrawal risk of liabilities from guarantees (**no. 5**) and liabilities from assets pledged as collateral for third-party liabilities (**no. 6**). Guarantees and indemnity agreements are not to be weighted if they are officially re-guaranteed by public institutions and the institution does not have to advance funds as the main guarantor. These items are to be classified in accordance with the accounting rules (see section 26 (2) and (3) of the *RechKredV*). For the weighting of placement and underwriting commitments (**no. 7**), the instructions pursuant to section 27 (1) of the *RechKredV* apply accordingly to memo item number 2b of Form 1, i. e. only the guarantee amounts that have not yet been drawn on are to be included. The liquidity-related withdrawal risk is limited to this amount. It is counted towards the following month at 20 per cent of the book value of the placement and underwriting commitments. The same weighting is applied for undrawn, irrevocable lending commitments (**number 8**), with the exception of irrevocable lending commitments for investment loans and mortgage loans which are to be disbursed in line with the progress of construction and are expected to be used during the 12 months following the reporting date (see subsection 3). Irrevocable lending commitments include all non-cancellable commitments that might give rise to a credit risk and that are to be reported under sub-caption 2c pursuant to section 27 (2) of the *RechKredV*. In particular, they comprise formal commitments to provide loans, buy securities or provide guarantees and acceptances. The duration of the commitment is irrelevant (see the Deutsche Bundesbank's announcement to the Central Credit Committee of July 30, 1997 - B2-2). Lending commitments in connection with funds transmitted in the context of promotional credits granted by third parties are not to be included.

Given the differences in the weightings for irrevocable lending commitments granted to credit institutions and customers, which are counted at 20 per cent (**no. 8**), and commitments received, which are counted at 100 per cent (section 3 (1) number 4), it is conceivable that a credit institution might attempt, with the

involvement of a third party, to take advantage of this discrepancy in order to raise its liquidity ratio (roundabout deal). Such practices would contravene the aim of the weighting regulations and would not be tolerated by the Federal Banking Supervisory Authority. At the first indication of a roundabout deal, the Banking Supervisory Authority shall request that the institution concerned gives an immediate explanation of the circumstances and demand an immediate termination of the abuses. Appropriate measures are likely to be taken against the responsible members of the management board after an individual case has been examined.

Subsection 2 lists the payment obligations that are recorded on the liability side of the liquidity recording scheme in line with their residual maturities. The residual maturities depend on the agreed maturity date of the transactions on which they are based. Only transactions with a residual maturity of up to one year are included. Since both the payment obligations themselves and their dates of maturity can be clearly determined, calls on the liabilities listed in subsection 2 can, unlike those listed in subsection 1, be precisely anticipated. Therefore, the weighting rates indicating the average withdrawal rates of liabilities without fixed maturities are not taken into account when recording the liabilities listed in subsection 2 (with the exception of number 3).

Liabilities to the Deutsche Bundesbank, the ECB and the other central banks belonging to the ESCB as well as to other central banks are to be recorded under **no. 1** (liabilities to central banks). In addition to obligations arising from open market operations, these liabilities also include the marginal lending facilities that have been drawn on. The loan sums offsetting the repayment obligations are counted as liquid assets under section 3 (1) number 2. These liabilities also comprise amounts owed to the ESCB by the institution as a transferee in bilateral repurchase agreements because the institution has an obligation to return the transferred securities. Furthermore, they also comprise forward-value commitments to the ESCB resulting from swap transactions.

Of the liabilities to credit institutions and liabilities to customers that are reported in the balance sheet under liability components **no. 1** and **2** (see section 21 of the *RechKredV*), those with residual maturities that do not exceed one year on the respective Principle reporting date (**no. 2 and 4**) are to be recorded in Principle II. This does not apply to liabilities to central banks, which are to be recorded under **no. 1**. Unlike the "old" Principles II and III, which were based on the principle of original maturity, the new Principle II does not use permanent average balances to determine the average withdrawal rate of liabilities because liquidity outflows can now be precisely determined on the basis of their fixed residual maturities. It has thus become unnecessary to lay down different weighting rates for liabilities to credit institutions, on the one hand, and liabilities to customers, on the other, to take account of the different withdrawal rates of fixed-date customer and bank deposits.

The liabilities of the central institutions of the savings banks and credit cooperative sectors to their regional institutions and of those regional institutions to their respective affiliated savings banks and credit cooperatives are assigned a weighting of 20 % (**number 3**). This special regulation takes account of the fact that liquidity in the credit cooperative and savings bank sector is interlinked: the associated

credit institutions are required, by their statutes or by-laws, to lodge excess liquidity with their appropriate regional institutions. According to information by the affected sections of the banking industry, this results in a considerably lower calling rate of deposits with central institutions, which justifies the reduced weighting rate.

Asset liabilities, i.e. obligations of the borrowing institution to return borrowed securities, are recorded separately under **no. 5**. The residual maturity of securities lending transactions is determined on the basis of the agreed retransfer (see section 6 (1) sentence 1 number 4). The recording of the asset liabilities arising from these securities lending transactions is offset by the recording of the borrowed securities under the liquid asset components. In this respect, the underlying methodology for recording securities lending transactions in the liquidity principles remains unchanged (see announcement I 4 - 212311 - 2/87 of August 25, 1987, reprinted in CMBS under number 17.18). The transferee's obligations to return securities transferred under genuine repurchase agreements are recorded as fixed-date liabilities under **no. 6**. They are offset by the securities acquired under the respective sale and repurchase agreements, which are recorded under the liquid asset components. The fact that securities transferred under sale and repurchase agreements are recorded as both asset and liability items in the transferee's liquidity return is based on the gross method of recording all planned liquidity flows, whereby both liquid asset inflows and payment obligations arising from sale and repurchase agreements are recorded.

Notwithstanding the balance sheet disclosure rules, **no. 7** stipulates that in the case of sales with an option to repurchase, the transferor must record money liabilities vis-à-vis the transferee at the amount to be repaid, provided that the current market value of the transferred securities is lower than the agreed amount to be repaid and a retransfer of the securities may therefore be expected. The recording of such money liabilities corresponds to the recording of matching money claims in the transferee's liquidity return (see section 3(2) number 8). If the market price of the transferred securities falls below the amount to be repaid, they are deducted from the portfolio of the transferee and counted towards the portfolio of the transferor (see section 5 (2) sentence 3). The transferor's money liabilities arising from genuine sale and repurchase transactions, by contrast, are recorded in accordance with the balance sheet disclosure rules as liabilities under number 2 (credit institution is the transferee) or number 4 (customer is the transferee).

Except for the limitation of the maturity to a maximum of one year, the definition of the liability item "securitised liabilities" (**no. 8**) is identical to that of the corresponding liability item number 3 in the balance sheet (see § 22 of the *RechKredV*). As with the disclosure requirements, the definition of the term "securities" and stock-exchange listing is not relevant here. The volume and maturity of the credit institution's payment obligations arising from its securitised liabilities depend solely on the agreed terms of repayment. The markets in which the issued debt securities and the other securitised liabilities are traded are irrelevant.

All liabilities with a residual maturity of up to one year which, in the event of a liquidation or bankruptcy,

may only be settled after the claims of other creditors are recorded under **no. 9** (subordinated liabilities). Capital represented by participation rights that has been transferred for a limited period and has a residual maturity of up to one year is recorded under **no. 10** (capital represented by participation rights).

No. 11 (other liabilities) comprises liabilities which will entail payment outflows within the next 12 months. Components that do not entail outpayments - such as received option premiums, for example - do not fall into this category. With this exception, the disclosure requirements for liability caption number 5 of form 1 pursuant to the *RechKredV* must be observed. If only liabilities arising from banking business are recorded under "liabilities to credit institutions and customers", the item "other liabilities" must include those liabilities to credit institutions and non-credit institutions that do not arise from banking business. Insofar as these liabilities have (residual) maturities, they must be allocated to the time bands of the liquidity recording scheme according to the due date of the payment obligation. "Other liabilities" that do not have maturities or where the (residual) maturity is unknown are allocated to the first time band (due on demand up to one month).

The assets and liabilities of branches of enterprises domiciled abroad (sections 53 (1) and 53b (1) sentence 1 of the Banking Act) vis-à-vis their head offices or other branches abroad that enter into the clearing balance continue to be recorded using the gross method (see announcement I 7 - A 31 - 5/93 of November 5, 1993; reprinted in CMBS under number 3.62). This means that the working capital provided by the head offices to the branch offices is not counted as equity capital; rather, the internal netting assets and netting liabilities that exist between the head office or branches domiciled abroad and the domestic branch must be counted as liquid assets or liabilities according to their residual maturities.

Irrevocable lending commitments for investment loans and mortgage loans to be disbursed in line with the progress of construction are weighted at the amounts which are expected to be used during the 12 months following the reporting date (subsection 3). For the sake of simplicity, the Principle specifies how the expected outpayments are to be allocated to the four time bands: 12 per cent are to be allocated to the first time band (**no. 1**), 16 per cent into the second time band (**no. 2**), 24 per cent to the third time band (**no. 3**), and 48 per cent to the fourth time band (**no. 4**). This is based on the assumption that recourse to the long-term credit lines will remain constant on a month-on-month basis – an assumption which is, by and large, supported by the credit institutions' experience from their long-term lending business. Callable loans with a fixed calling date and a pre-determined volume, by contrast, are to be entered in full in their respective time band.

Section 5

Securities repurchase and lending agreements

Section 5 contains general rules for recording securities repurchase and lending agreements. A separate regulation is necessary because neither the balance sheet disclosure regulations nor the corresponding

weighting regulations laid down in Principle I enable the liquidity effects resulting from securities repurchase and lending agreements to be captured in a way that is compatible with the methodology of Principle II.

The liquidity effects resulting from securities repurchase and lending agreements are recorded using the gross method. This means that both the (potential) inflow of liquid assets and the liabilities arising from these transactions are taken into account. Notwithstanding the balance sheet disclosure regulations, the *liquidity reserve* embodied by the securities is included in the liquid assets of the contracting partner who has the right of disposal over the securities. At the same time, the obligation to retransfer the securities is recorded as a *fixed-date liability* under the liabilities of the party which has the obligation to retransfer the securities at a future point in time. The resulting net effect depends not only on the difference between the inflows and outflows of liquidity (*amount component*), but also on the timing of the liquidity inflows and outflows (*time component*).

In the case of repurchase and lending transactions with a residual maturity of more than one year, the transferee/borrower records the increase in the liquidity reserve, but not the obligation to return the securities, under the liability items. The reason for this asymmetry is that the liquidity recording scheme, with its breakdown into time bands, lacks a time band for liabilities with a residual maturity of more than one year. This asymmetry, which benefits the credit institutions, is acceptable because only the liquidity ratio plays a role in determining whether a credit institution has adequate liquidity.

The following tables give a systematic overview of how the liquidity effects of the individual components of securities repurchase and lending agreements are to be recorded by the transferor/lender and the transferee:¹

a) Genuine sale and repurchase transaction

| Genuine sale and repurchase transactions | |
|--|---|
| <i>Liquidity effect on the transferor's side</i> | <i>Liquidity effect on the transferee's side</i> |
| 1. Cash inflow | 1. Cash outflow |
| 2. Recording of the money obligations | 2. Recording of the money claims |
| 3. Recording of the asset claims to the return of the securities * | 3. Enlargement of the securities portfolio * |
| 4. Reduction of the securities portfolio * | 4. Recording of the <u>asset liabilities</u> to return the securities * |

The procedure for recording genuine securities sale and repurchase transactions laid down in subsection 1 (see section 340b (2) of the Commercial Code) concerns the cash holdings, money claims and money obligations, and securities portfolios of both the transferor and the transferee.

¹ In the following tables, the asterisk * indicates the adjustment entries that do not correspond to the accounting rules.

Notwithstanding the balance sheet disclosure rules, the liquidity embodied by the securities is attributed to the transferee for the duration of the sale and repurchase transactions. Accordingly, the transferee must include the securities he receives in the context of genuine sale and repurchase transactions, if they are quoted on a stock exchange, as highly liquid assets in the first time band for the duration of the transaction in accordance with the classification principles laid down in section 3 (1), read in conjunction with section 5 (1). If the securities are not quoted on a stock exchange, the recording of the transaction does not depend on the residual maturity of the sale and repurchase transaction alone, but rather on the residual duration of the sale and repurchase transaction plus the residual maturities of the transferred securities at the end of the transactions. This also holds true for sales with an option to repurchase and for lending agreements with unlisted securities. The inclusion of the transferee's asset claims in the appropriate time band also depends on the residual duration of the transaction. The transferor does not have disposal of the transferred securities during the duration of the sale and repurchase transaction. Since he knows the exact retransfer date, however, he must record them in the liquidity recording scheme according to the residual maturity of the transaction. The transferor must deduct the securities from his portfolio for the duration of the sale and repurchase transaction and record them as asset claims arising from genuine sale and repurchase transactions. In addition, the transferor and transferee must also include the liquidity-providing or liquidity-absorbing effects of the inflows and outflows of funds agreed in connection with the payment. Furthermore, both the transferor and the transferee must include a fixed-date liability in their liability items to the amount of the sum to be repaid according to the respective residual duration of the sale and repurchase transaction.

b) Sales with an option to repurchase

| Sales with an option to repurchase | |
|---|---|
| <i>Liquidity effect on the transferor's side</i> | <i>Liquidity effect on the transferee's side</i> |
| <ol style="list-style-type: none"> 1. Cash inflow 2. Reduction of the securities portfolio 3. For the period of time during which the current market value of the transferred securities is lower than the agreed repurchase price, the transferor shall <ol style="list-style-type: none"> a) include a money liability to the amount of the sum to be repaid * b) include the transferred securities in his portfolio at their market value * | <ol style="list-style-type: none"> 1. Cash outflow 2. Enlargement of the securities portfolio 3. For the period of time during which the current market value of the transferred securities is lower than the agreed repurchase price, the transferee shall <ol style="list-style-type: none"> a) include a money claim to the amount of the sum to be repaid * b) deduct the transferred securities from his portfolio at their market value * |

The procedure for recording sales of listed securities with an option to repurchase laid down in subsection 2 (see section 340b (3) of the Commercial Code) differs from the procedure for genuine sale and repurchase transactions with respect to the recording of the liquidity effects arising from the retransfer of the transferred securities. This difference results from the situation of the transferee, who is entitled, but not required, to retransfer the securities received under the sale with an option to repurchase. Since it is not certain whether the transferee will make use of his right to retransfer the securities, the transferor should not include the inflow of liquidity arising from the retransfer. The further recording of liquidity effects is now chiefly geared to the development of the transferred securities' market value, which has the following implications:

1. The transferor must consider the possibility of the securities being retransferred when the market value of the securities is lower than the agreed repurchase price. In this case, the transferor must record a money liability to the amount of the sum to be repaid. Additionally, he must include the transferred securities, at their respective market values, in the appropriate time band. These two processes must be recorded either on the basis of the residual maturity of the repurchase agreement or, if there is no residual maturity (i. e. in the case of a repurchase agreement without a fixed date), on the earliest expected retransfer date. In most cases, this is likely to be the first time band. The transferee must deduct the transferred securities from his portfolio to the amount of their respective market values and replace them with a asset claim to the amount of the sum to be repaid.

2. The transferor does not expect the securities to be retransferred when the market value of the securities is higher than the agreed repurchase price. In this case, neither the transferor nor the transferee should take any action.

c) Securities lending agreements

Subsection 3 specifies that, with regard to the recording of the transfer and retransfer of the securities, the provisions on genuine sale and repurchase transactions shall apply accordingly to (unsecuritised) lending agreements. This also becomes evident in the table below:

| Lending agreements | |
|--|---|
| <i>Liquidity effect on the lender's side</i> | <i>Liquidity effect on the borrower's side</i> |
| 1. Recording of the asset claims to the return of the securities | 1. Enlargement of the securities portfolio |
| 2. Reduction of the securities portfolio | 2. Recording of the asset liabilities to return the securities. |

Section 6
Valuation Basis

The basis for the valuation of liquid assets and payment obligations is laid down in section 6. Subsection 1 specifies the valuation basis for asset and liability items. Subsection 2 contains instructions for converting asset and liability items denominated in foreign currencies into Deutsche Mark; this regulation is closely modelled on the corresponding regulation in section 6 (2) of Principle I.

Subsection 1 lays down the valuation basis for liquid assets and liabilities and contains information on the determination of market prices and on flat weighting rates for recording book values. With regard to the valuation basis, sentence 1 distinguishes between four groups: firstly, liquid assets, which are counted at the respective current market prices of the underlying securities; secondly, shares in money market and securities funds, which are counted at the repurchase prices on the respective reporting dates; thirdly, money claims of the transferee pursuant to section 3 (2) number 8 and payment obligations arising from securitised liabilities, which are counted at the respective amounts to be repaid; and fourthly, other liquid assets and liabilities, which are counted at their respective book values. The first group comprises listed securities, collateralised debt securities, and securities-related inflows and outflows of liquidity arising from repurchase and lending agreements (see numbers 1 and 4). The second group comprises shares in money market funds and the special securities funds (liquid assets pursuant to section 3 (1) number 7). The repurchase price is based on the issue price, which is determined by investment companies pursuant to section 21 of the Investment Companies Act (*Gesetz über Kapitalanlagegesellschaften* or *KAGG*), as they fall under the provisions of this Act. The third group comprises payment obligations arising from securitised liabilities, which are to be counted at the respective amounts to be repaid; claims of the transferee vis-à-vis the transferor arising from sales with an option to repurchase are also to be counted at the amount to be repaid if the market value of the securities transferred is lower than the agreed amount to be repaid. The fourth group comprises the other liquid assets and liabilities pursuant to sections 3 and 4. Off-balance-sheet transactions that are shown below the line are to be valued on the basis of the book value pursuant to section 24 of the *RechKredV*. The resulting deduction of any provisions shown as liabilities owing to anticipated losses arising from uncompleted transactions is chiefly geared to taking account of the credit risk. Within the framework of the liquidity regulations, the deduction of provisions shown as liabilities is acceptable as long as the amounts recorded are not substantially lower than the amounts that may possibly have to be paid out.

Sentence 2 specifies that the market prices to be used are the prices or market prices officially quoted or determined at the close of business on the respective reporting date. If the reporting date falls on a day that is not a business day, the securities are to be recorded on the basis of the situation at the end of the last business day before the reporting date. The market rates to be used are the officially quoted rates or – if these are not available – market rates calculated on the basis of market parameters. The institution should document the theoretical valuation method and input data it uses and disclose them to the Federal Banking Supervisory Authority at its request.

If it is not possible to record the securities at their current market prices, the institutions may count them at a certain proportion of their book value (sentence 3). Deductions are made to prevent a possible

overvaluation of the liquidity absorbed in the securities if the value that can be obtained in the event of the securities being realised is lower than the book value. Listed debt securities and other fixed-interest securities are counted at 90 per cent of their book value irrespective of their (residual) maturities. Listed shares and other non fixed-interest securities are counted at 80 per cent of their book value. The way in which the deduction rates are determined is based on the consideration that, owing to changes in the market, the price achieved when selling the securities can fall below the book value. Since share prices empirically fluctuate more strongly than fixed-interest debt instruments, the deduction rate for listed shares is higher than that for quoted debt instruments. Shares counted at their book value are only taken into consideration if they are listed.

According to sentence 4, lump sum adjustments and country risk value adjustments are to be deducted from the book values of the respective asset items because the risk situation gives due cause for doubt as to whether the loans will be repaid to the full amount of the existing claims. If value adjustments are carried out, there are no guaranteed payment rights. The deduction rules also apply to individual value adjustments provided on assets which are not currently non-performing and therefore do not impede the overall recording of liquidity arising from value-adjusted claims (see section 3 (3) number 1). The value adjustments are to be deducted from their respective asset items pursuant to sections 3 (1) and 3 (2). If an institution is unable, for technical reasons connected with the reporting procedure, to make a deduction from the asset item in question, it may, upon informing the Federal Banking Supervisory Authority, apply a flat-rate procedure for deducting value adjustments: in this case, the total value of the adjustments provided on assets are to be deducted from the liquid assets in the first time band according to the share of countable liquidity items in the sum total of all asset items subject to the value adjustments. Individual value adjustments which prevent the corresponding loans and bills of exchange from being counted (see section 3 (3) number 1) are not taken into account. The deduction of value adjustments calculated using the flat-rate procedure leads to a reduction of the liquid assets to be recorded in the first time band. This may, in some cases, be associated with a disproportionately high burden with regard to the liquidity to be counted, but the restriction to the first time band constitutes a simplification. The following example helps demonstrate the flat-rate deduction procedure: the asset items subject to value adjustments amount to a total of 5,000 money units (MU); 2,000 MU constitute liquid assets countable towards Principle II, and 1,000 MU of these are to be recorded in the first time band (each taking due account of the deduction item pursuant to section 3 (3) number 1). With regard to the regulation on deductions pursuant to section 6 (1) sentence 4, lump sum adjustments, country risk value adjustments and other value adjustments which do not which prevent the corresponding loans and bills of exchange from being taken into account (see section 3 (3) number 1) are to be deducted to the amount of 50 MU, 40 MU and 10 MU, respectively, i. e. a total of 100 MU. The value adjustments are to be deducted from the liquid assets to be included in the first time band according to these asset items' share in the sum total of all asset items subject to the value adjustments:

$$1,000 - 100 \cdot (1,000 / 5,000) = \underline{980}.$$

980 MU are to be included as liquid assets in the first time band. Before making use of their option for

the first time, the institutions must inform the Federal Banking Supervisory Authority that they intend to use the simplified procedure and indicate the value adjustment to which they will apply the procedure and the asset items that will be included. The Federal Banking Supervisory Authority can reject the use of the flat-rate procedure if there are grounds to believe that it would lead to the liquidity-reducing effects resulting from the value adjustments being underrecorded.

The previous approval of passive accrual items on the deduction of fees booked but chargeable to subsequent accounting years in instalment financing business and the discounting of loans from the corresponding asset items, laid down in the old versions of Principles II and III (see announcement I 3 - 4214 - 1/70 of May 15, 1979, printed in CMBS under number 3.09, and announcement I 3 - 4214 - 5/75 of July 24, 1975, printed in CMBS under No. 3.23), expires with the revised version of Principle II. In the new liquidity recording scheme, revenue that is received before the reporting date but represents – in part or in whole – income for a certain period after the reporting date is included in its entirety – i. e. irrespective of the prepayments and accrued income item - as additional liquid assets because it is available, without restrictions, for the settlement of payment obligations. However, the institutions can also choose to keep recording prepayments and accrued income in Principle II, as well. The decision not to make deductions must be reported to the Federal Banking Supervisory Authority before the first application of that decision. Once a method has been chosen, it must be adhered to in future.

Subsection 2 specifies the method for converting asset and liability items denominated in foreign currency into the reporting currency (Deutsche Mark or euro); all items not denominated in euro or the currencies of the other EMU member states are to be considered as denominated in foreign currency. Currency conversion is to be based on the reference rates quoted by the ECB on the respective reporting date and published by the Deutsche Bundesbank (“ESCB reference rate”). Currencies for which no ESCB reference rate is published are to be converted on the basis of the middle rates derived from the determinable buying and selling rates quoted on the respective reporting date. Subsection 2 corresponds to the regulation on currency conversion pursuant to the Deutsche Bundesbank’s guidelines for balance sheet statistics, which entered into force in January 1999.

Section 7

Residual maturities

The regulation of section 7 concerns the determination of residual maturities of liquid assets and liabilities in Principle II. The allocation of the liquid assets and liabilities to the time bands of the liquidity recording scheme pursuant to section 2 (1) depends on their residual maturities. Liquid assets pursuant to section 3 (2) and liabilities pursuant to section 4 (2) have residual maturities; liabilities pursuant to section 4 (3) are to be included according to their estimated maturities. Residual maturities are irrelevant for liquid assets pursuant to section 3 (1) and liabilities pursuant to section 4 (1) because these items can either not be assigned maturities or because they are treated like assets and liabilities due

immediately. With one exception (see sentence 4), the determination of residual maturities in Principle II fundamentally corresponds to the disclosure requirements for financial statements. The relevant factor is the contractual residual maturity of the transaction or the object of the transaction, but not the residual interest rate lock-in period.

Sentence 1 specifies the period to be regarded as the residual maturity in individual cases. The residual maturity is generally deemed to be the period of time between the respective reporting date and the due date of the liquid assets or liabilities **(no. 1)**. This corresponds to the provisions of section 8 of the *RechKredV* (Remaining Term). Numbers 2 to 5 and sentences 2 to 4 contain more precise definitions of and exceptions to the general provision of number 1 of this section. **No. 2** specifies, in line with section 8 (1) of the *RechKredV* that in the case of uncalled deposits at notice, the respective period of notice is deemed to be the relevant residual maturity. If a blocked notice period was agreed on in addition to the period of notice, the blocked notice period is to be added to the period of notice. In the case of assets and liabilities to be repaid in regular instalments, the period of time between the respective reporting date and the due date of the partial amount is deemed to be the residual maturity **(no. 3)**. This corresponds to the regulation pursuant to section 8 (2) of the *RechKredV*, with the reporting date according to Principle II replacing the balance sheet date. Numbers 4 and 5 contain special regulations regarding residual maturities in the case of securities repurchase and lending agreements. The residual maturities of liabilities resulting from genuine securities repurchase and lending agreements are determined according to the residual duration of the transaction **(no. 4)**. The residual duration of the transaction is also relevant for the recording of liquidity inflows arising from the transfer of listed securities and collateralised debt securities at the end of a repurchase or lending agreement. Since this paper can immediately and readily be converted into cash, only the residual duration of the transaction is of relevance. This is not the case for the recording of liquidity inflows resulting from retransferred securities that are neither listed securities nor collateralised debt securities. In this case, the inflows of liquidity are counted after the end of the remaining duration of the transaction plus the residual maturity of the date of the securities on which the transaction is based **(no. 5)**.

The specifications in sentences 2 and 3 regarding the determination of residual maturities correspond to the regulations laid down in section 8 (1) and (2) of the *RechKredV*. Sentence 2, which specifies that possibilities of early termination shall be considered for liabilities, but not for claims and securities, corresponds to section 8 (1) sentence 3 of the *RechKredV*. Given the withdrawal risk (on the liabilities side), it is logical to record liabilities as soon as possible but not to count liquid assets until the liquidity inflows are certain to have occurred. Sentence 3, which specifies that in the case of annuity loans, the amounts to be repaid are to be allocated to the relevant time bands to the value of the respective instalments, supplements the regulation on residual maturities for assets and liabilities to be redeemed in regular instalments pursuant to sentence 1 number 3. This corresponds to the accounting regulation pursuant to section 8 (2) of the *RechKredV*.

Sentence 4 contains a regulation on day-to-day money and money at call which differs from the disclosure regulations (see section 8 (3) of the *RechKredV*). Pursuant to this regulation, day-to-day

money lent in the context of interbank business until further notice (“day-on-day money until further notice”) and money with a daily notice period (“overnight money”), in particular, are not to be recorded as liabilities due to credit institutions on demand (section 4 (1) number 1), but rather as liabilities to credit institutions with an agreed maturity date or period of notice of one year or less (section 4 (2) number 2). Day-to-day money with a daily notice period is considered to be a time deposit for one day – irrespective of whether “until further notice” is added or not. The asset’s maturity of one day is prolonged by one day if the funds are not withdrawn when they mature. According to established market practices in the interbank money market, adding “until further notice” is intended to prevent that extended day-to-day money which is supposed to be left for another day when it matures having to be renegotiated every day.

Section 8

Special regulation for mortgage banks

Section 8 contains a special regulation for mortgage banks on the basis of so-called quasi-redemptions. Quasi-redemptions are mortgage bank loans which become due or may become due in connection with an interest-rate adjustment (see announcement III 44 - 1522 of January 30, 1980, footnote number 2 on the diagram on the liquidity development of public mortgage banks; printed in CMBS under number 8.18). Mortgage banks generally extend fixed-rate mortgage loans and local authority loans by means of what is known as partial segment financing. At the end of the interest-rate lock-in period, the lending rates are renegotiated. If a new arrangement is made, the loan contract continues to exist, but with a different interest rate and a new lock-in period. If, on the other hand, no arrangement is made, the loan shall be repaid upon expiry of the lock-in period (quasi-redemption). Correspondingly, mortgage banks design and refinance real estate loans segmentally.

If mortgage banks’ long-term fixed-rate loans were recorded in the liquidity principle according to their residual maturities, the mortgage banks would have considerable difficulties in achieving the liquidity ratio of at least one, which is based on the short-term period of one month. But since the minimum liquidity regulation in section 2 (2) sentence 3 also applies to mortgage banks, it was necessary to lay down a special regulation for mortgage banks which provides that a certain share of the outstanding mortgage loans and local authority loans, determined on the basis of long-term experience with quasi-redemptions, is regarded as being due within the next 12 months.

Numbers 1 and 2 lay down the weighting to be applied to mortgage loans and loans to local authorities which will become due within the 12 months of the reporting date in connection with an interest-rate adjustment when they are recorded under the liquid assets. The weights (20 per cent for mortgage loans, 10 per cent for loans granted to local authorities) are based on experience and reflect the average rates of quasi-redemptions. Said mortgage and local authority loans are to be allocated to the time bands of the liquidity recording system according to their residual maturities. The residual maturity is the period of time between the respective reporting date and the expiry of the interest rate lock-in period, which is

when the repayment of the loan may be expected **(no. 3)**. If a mortgage bank is unable, for technical reasons pertaining to the reporting procedure, to break down the loans into the individual time bands according to their respective residual maturities, it may include the quasi-redemptions expected each year into the time bands on a pro-rata basis. Loan amounts which are certain to be redeemed prior to maturity on the reporting date are weighted using the general weighting principles; these amounts are exempt from the special regulations for quasi-redemptions.

For the sake of clarity, **no. 4** specifies that all other regulations pursuant to sections 1 to 7 and section 10 of Principle II apply unchanged to the mortgage banks.

Section 9

Special regulation for building and loan associations

The old Principles II and III did not apply to building and loan associations. Owing to the growing importance of their non-collective building loan business and their concomitant approximation to universal banking business, special regulations pertaining solely to building and loan associations are no longer adequate. For this reason, building and loan associations now also come under the purview of the new Principle II.

Applying the weighting principles of Principle II to the non-collective business of building and loan associations is unproblematic. The liquidity effects resulting from such business are recorded in accordance with the provisions laid down in sections 3 to 7 **(no. 1)**. The unmodified application of Principle II to the liquid assets and liabilities arising from actual building loan business (collective business), on the other hand, would encounter difficulties since fixed residual maturities cannot be assigned to the individual assets and liabilities. These problems are resolved by basing the recording of the liquidity drain on the difference between liquid assets and liabilities arising from collective business and, for reasons of practicability, including a certain percentage of this difference in the first time band. Accordingly, **no. 2** specifies that 10 per cent of the difference between the deposits and the loans under savings and loan contracts shall be included among the liabilities in the first time band. The weighing is based on the empirical figures of the building and loan associations. This regulation establishes the basis for an adequate liquidity management with regard to the expected outflows arising from collective business. **No. 3** specifies that all other provisions pursuant to sections 1 to 7 and section 10 of Principle II apply unchanged to the building and loan associations.

Section 10

Reporting of the ratios

Section 10 lays down the reporting procedure for Principle II. The procedure for the former Principles II and III remains unchanged. This means that the institutions must calculate their liquidity ratios at the end of each calendar month and, using the official reporting forms, submit them no later than the fifth business day of the calendar month following the reporting date to the responsible Land Central Bank or, in the case of credit institutions that , perform central functions throughout Germany within the meaning of section 7 (2) sentence 2 number 2 of the Bundesbank Act, i. e. the German Equalisation Bank (*Deutsche Ausgleichsbank*), the Agricultural Mortgage Bank (*Landwirtschaftliche Rentenbank*), the Export Credit Company (*Ausfuhrkredit-Gesellschaft mbH*) and the Liquidity Consortium Bank (*Liquiditäts-Konsortialbank*) – to the Central Office of the Deutsche Bundesbank. The deadline for submission is extended to the seventh business day of the calendar month following the reporting date if the institute submits the report by data telecommunication. The monthly reports comprise the liquidity ratio pursuant to section 2 (2) sentence 2 and the observation ratios pursuant to section 2(3) sentence 1 and are to be submitted on official reporting forms.

III. Entry into force and first application of Principle II

The new version of Principle II shall come into force on July 1, 2000 (see item 2 of the announcement of the amendment of the Principles). At that time, the Preamble to the Principles Concerning the Own Funds and Liquidity of Institutions and Principle III shall become ineffective (see items 1 and 3 of the amendment announcement). This means that all institutions that fall within the scope of the new Principle II must submit reports on the new Liquidity Principle II for the first time as at July 31, 2000. The former Liquidity Principles II and III shall be reported until June 30, 2000. Credit institutions that wish to apply the new Principle II before July 1, 2000 may switch from the former Principles II and III to the new Principle II after January 1999 (see item 4 of the amendment announcement). The intention to change over to the new Principle II must be reported to the Federal Banking Supervisory Authority, the responsible Land Central Bank and - in the case of credit institutions that perform central functions throughout Germany – to the Central Office of the Deutsche Bundesbank in due time before the first report following the changeover. The changeover to the new Principle II must be maintained.