German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

On the EBA discussion paper "On retail deposits subject to higher outflows for the purposes of liquidity reporting under the draft CRR"

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Berlin, 13-03-21

The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,000 banks.

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Comments "On retail deposits subject to higher outflows for the purposes of liquidity reporting under the draft CRR"

On 21 February 2013, the European Banking Authority (EBA) published its discussion paper entitled "On retail deposits subject to higher outflows for the purposes of liquidity reporting under the draft CRR". The German Banking Industry (GBIC) hereby gladly seizes the opportunity to share its respective comments.

I. General

First, we would like to point out that, pursuant to Article 409(3) CRR, the criteria covered by the discussion paper serve identifying retail deposits that shall be subject to higher outflow factors than the outflow factors regulated under paragraph 1 and 2. In the view of the GBIC, application of the 5 percent outflow rate shall not be prejudiced provided the preconditions specified under paragraph 1 are met. This means that retail deposits which are part of an established relation or which are held on a current account shall generally be regarded as so-called "stable deposits" with a 5 percent outflow rate provided they are covered by the respective deposit protection scheme.

This translates into the following practical requirements:

- First, the preconditions set out under paragraph 1 would have to be verified; provided the preconditions are met, the deposit shall be subject to an outflow factor of 5 percent;

- Subsequently, there will be a review concerning compliance with the criteria as set out under the EBA's forthcoming guidelines (for which the EBA received a mandate under the provisions Article 409(3)). Potentially, said guidelines will incur a higher weight (15%/20%/25%);

- If neither item one nor item two are applicable, the deposit shall be subject to an outflow weight of 10 percent as set out under Article 409(2).

Whilst we generally agree with the EBA in implementing a uniform approach within the EU, it appears that the proposed methodology to identify retail deposits subject to higher outflows, as well as the proposed calibration of the scorecard is overly conservative and does not correspond with the experience witnessed by us and other market participants. We would be glad to deliver additional data to complement the data gathered by the EBA from national supervisors.

An overly conservative and restrictive approach to retail deposits within the EU incurs the risk of potentially driving clients into unwanted deposit products, or even outside of Europe given the implications of less stability on the attractiveness of offering such products. This then has knock-on consequences for the ability of European banks to provide credit to the broader economy, or the attractiveness of lending products.

We would welcome information on the empirical data the EBA was receiving that informs the current analysis. We believe it would be helpful to understand if any (regional) pattern emerged and to analyse in more detail what the driver behind such regional differences may be applicable.

Whenever deposits are earmarked for special purposes, we hold the view that banks should be able to waive the review of the deposit's risk factors ex ante. Whilst not limited to, this proposed waiver especially relates to building society deposits where the client is not free to dispose of such deposits ad lib. or, moreover, where such disposal would incur negative consequences for clients. After all, - regardless of

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their level ("high value") or potential "preferential conditions" to name but two risk factors suggested by the EBA - these deposits precisely do not serve to generate short-term interest income gains.

We have serious concerns over the proposed multi-tier approach (ten very high risk factors and high risk factors – including "other characteristics"). We have specified these concerns in greater detail in response to the questions below. Aside from the meaningfulness of such data, in practice, it turns out that not all the information on the deposit would be available. Rather, when it comes to certain factors, banks would have to collate the data especially for this sole purpose. Hence, the implementation would be extremely complex. After all, in an initial step, it would be necessary to create the requisite framework. Whilst the supervisory insight gained is not justified by a cost-benefit analysis, the computation methodology presented in the discussion paper would tie up considerable administrative resources and IT resources. We are also of the opinion that limiting the number of characteristics would not result in a lower quality of the analysis.

As far as earmarked retail deposits are concerned, we therefore kindly ask exempting the latter from the assessment concerning high and very high outflow rates. On the other hand, we could also imagine admission of offsetting this against mitigating effects (e.g. [despite the fact that] they could be withdrawn on a daily basis without any prior notice, [some] deposits are held on an account over several years).

We have doubts over the practical feasibility of implementing all nine (ten with "other characteristics") of the criteria suggested by the EBA. Hence, we suggest focussing on prioritised criteria. These criteria should be used as a proxy for all criteria presented.

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II. Specific Comments

Q1. How do respondents assess the availability of data to empirically substantiate work on criteria for identification of retail deposits subject to higher outflows, as well as setting such outflow rates?

Given confidentiality issues, it has always been extremely hard to find objective market data that provides evidence of how deposits products have behaved in crisis situations. That information that is available, however, generally shows that compared to many other funding sources, retail deposits are one the most sticky forms of unsecured financing for a bank, and outflows within a period of 30 days of severe stress are contained to 10%-15% at maximum. The EBA referenced analysis of outflows from 25%-100% in certain deposit products is not recognized by the information available to us.

The data for a more detailed empirical analysis of the individual accounts and account networks based on the specified criteria partly ties up major technical resources and HR. More specifically, we doubt whether an implementation is realistic at all. Particularly, a comparison to a peer group is unfeasible. However gathering and analyzing this information needs a substantial period of time as well as resources that would be better allocated elsewhere within a bank.

The challenge in general is that all historic data available do not indicate any unexpected or unmanaged outflow of deposits, even through the recent financial crisis. As a result, it is difficult to calibrate or to validate hypothetical stress scenarios with significant outflows.

The time series analysis is hampered by the fact that the data is not available with regard to all dimensions that need to be considered going forward. Instead, such data are only available at a relatively highly aggregated level (for example changes in the portfolio structure make it difficult to generate consistent time series on a business unit level). It takes time to build the required time series (including the relevant attributes). However, there are hardly any relevant criteria for identifying deposits with higher outflow rates. These criteria would first have to be defined, and would then have to be applied at the level of individual customers and products. For every single bank, this is extremely aggravating. Retroactively, this is either virtually impossible or only possible to an incomplete extent. Also, the additional qualitative criteria (such as "sophistication" or "high net worth") lack any methodology. As a consequence, a classification or allocation is virtually impossible.

The general idea of a differentiation between various deposit types or, respectively, depositor types seems reasonable from the bank's perspective as especially rate-driven deposits as a sole relationship with the depositor can show a lower stability in volume over time than other types of deposits.

The treatment of deposits of small medium enterprises remains unclear in the proposal.

Deposit outflows observed in some jurisdictions should not be generalized as they are due to specific regional economic causes rather than general customer or product related behaviour.

The current proposal broadens the already existing criteria (like established relationship or transaction accounts) by nine additional criteria. We propose striking a balance between the criteria that are essential from a risk perspective but are still manageable for the steering of these deposits.

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We believe that all factors mentioned provide an appropriate universe to assess stability of deposits. We do not hold the view that there is any other factor which would be relevant in that respect. We rather feel that reducing the number of characteristics would be called for.

Regarding the proposed factors we would like to elaborate the following:

ad 4. High risk distribution channels

Of course, the distribution channel can affect the stability of retail deposit products. But past experience has shown that internet-only customers did not react more quickly to market developments than other customers. Whilst these deposits may potentially be less stable this is not necessarily the case. Therefore, the distribution channel itself should be seen in connection with the characteristics of the underlying business relationship. In other words, the criteria worth assessing are whether the retail client only has a deposit account or whether they have an extended relationship including current account, instalment credit, mortgage loans, custody account.

ad 6. Non-resident deposits:

In principle, we agree with the explained differences between resident deposits and non-resident deposits. However, regarding banks focusing on internet-banking, the discussion paper’s arguments justifying the role of the customer's residence remain unconvincing. The criteria should furthermore not only look at a bank’s place of business but should also take into account the potential brand coverage. E.g. non-resident clients might perceive a branch of a foreign bank as a “local bank”.

The discussion paper mentions “… In general, the identified characteristics are linked to the degree of professionalism in the management of the deposits. Under an institution-specific or systemic stress, the more actively managed deposits will be more prone to experience withdrawals.” Does this refer to the ‘professionalism in the management’ on client side or on banking side?

Q2. Can you identify any other factors that may lead to higher outflows, especially in relation to the introduction of innovative products designed to lower outflow rates?

We have identified no other indicators that could lead to higher outflow vectors, and have not introduced innovative products designed to lower outflow rates. Depending on the final EBA rules on the treatment of retail deposits, however, introducing such products to mitigate the negative consequences of the discussed approach should not be ruled-out.

Q3. Do you agree with this characteristic? Should the local DGS amount be used instead of a fixed 100.000 EUR? Is it sensible to distinguish between high and very high value deposits? What are the concentration analysis and management tools used internally as regards high value deposits?

In our opinion, the proposed fixed amount of 100,000 EUR is inappropriate. Investor behaviour is not primarily affected by this low amount. An institute-specific investor credit rating only becomes relevant (regardless of the investor’s professionalism) above this threshold. Furthermore, it is worth noting that during times of crisis clients will be very safety conscious. They will probably have a greater tendency to withdraw any funds exceeding the [amount guaranteed by the] deposit protection scheme. In this context, we should like to highlight the importance of ensuring recognition of national deposit protection

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schemes and institutional protection schemes featuring a comprehensive deposit protection. If the EBA dismisses the national deposit protection as a rationale for stable deposits it should at least be acknowledged to a high percentage and not dismissed in full.

Based on the foregoing, we suggest using **either** and preferably the liability threshold of the local deposit guarantee scheme (DGS) or institutional protection scheme (IPS) **or** the 1 million euro amount threshold.

The local DGS or IPS are effective risk mitigation tools protecting the customer against a loss of their deposits. This inspires more confidence which in turn leads to more stability.

Rather than segregating deposits into high value and very high value, one categorization for deposits in excess of EUR 1mn or local DGS or IPS should satisfy to appropriately capture the category that could be assigned a higher outflow rate.

The application of a regular concentration analysis seems reasonable to us and is a tool which we consider as well. Typically, the concentration analysis can be used in various ways. For instance, in the variable deposits for the purposes of creating product bundles as well as for model validation. One option would be comparing the deposit volume of a certain percentage of the highest client depositors to the total volume. If this value exceeds a certain threshold, then these deposits are considered with higher outflow rates.

The DP mentions "… The evidence from supervisory authorities indicates that outflows ranging from 20 percent and substantially more seem to be warranted …." We would be interested to learn more about the underlying analysis. We assume that the observation was not equally distributed across countries, nor across different types of banks. We cannot confirm this outflow rate during the years of financial crisis. But besides our individual historic data, we suspect that other countries might have seen such outflow rates. We would like to learn whether such outflows can be linked to particular circumstances in the relevant countries.

Q4. Do you agree with the criteria for deciding which products can be considered as rate-driven?

Whilst in principle, we agree with the criteria used in order to categorise products as rate-driven, we don't believe this to be an appropriate tool to assess the stability under assumed stress scenarios. Firstly, deposits that are rate-driven are often provided by clients who solely look at the rates offered by banks, neglecting the fundamental factors of the bank behind the product offering such as financial soundness, capital ratios, or other critical indicators that usually form part of a credit decision. Hence, we do not concur with the assumption that such deposits are more sensitive to stress than other deposits. However, we feel that selecting a peer group is a highly complex process which is compounded by the fact that it would have to be repeated in regular intervals given that market conditions in the retail market may be subject to rapid change and due to the fact that this [process] has to be agreed with the national supervisor.

In addition, this tool is operationally difficult to introduce as the selection of respective benchmark rates is highly subjective and arbitrary. Whilst there will always be differentiation between different products of a bank in the market, the reduced stability factor which the EBA assumes for such deposit categories is usually off-set by the broader range of deposit products offered with lower yields.

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Whilst there is an element of prudential supervision involved for banks trying to attract deposits through highly attractive offerings only, it would be misplaced to capture this in the EU LCR standard. Instead, it is advisable to address this by means of line-supervision and the internal liquidity risk model.

In principle, in order to decide which products can be considered "rate-driven", the spread over the maturity matching EURIBOR benchmark interest rate is a suitable criterion. Notwithstanding the foregoing, a comparison with a peer group appears technically problematic and requires publicly available benchmarks that are fit for purpose. However, there are also deposits that are not tied to a reference interest rate but which, instead, tend to feature a fixed interest rate. The latter is due to the underlying established relation which is not affected by the market interest rate. Banks should therefore be entitled to prove by means of corresponding evidence (for instance by providing a sufficiently long track record) that these specific deposits are not "rate-driven".

The national supervisor should not have the right to select the peers. This should be done by the institution itself, subject to the usual audits and bearing in mind the complexity. Our reasoning behind this is that, especially within the German market, several business models compete resulting in material differences in the pricing for products e.g. cash deposits.

The DP specifies "… Peers in this regard refers to institutions with a comparable business model and size, to be defined by the national supervisor, or - by consent of the supervisor - by the institution verified by the national supervisor upon request …". We would be interested to know on which basis the national supervisors determine the peer group of a bank.

We agree with the assessment that rate-driven products may show a different stability (customer behaviour) than rate-insensitive products.

To some extent, we believe there is a positive correlation between a premium paid to the customer and its associated stability. There is some sort of a circular argument to be considered: Once a deposit is stable, it deserves a higher reimbursement; a higher reimbursement makes the customer willing to keep the deposit with the bank. In our understanding, this is accounted for by setting a sort of threshold rate (25 percent as suggested in the text). Given the currently low interest rate level for deposits, the 25 percent threshold might be too small. For instance in a low interest rate environment, the classification as "rate-driven" with an interest rate of 25 percent above the peer group can be exceeded quickly (e.g. peer group 0.1 percent, bank 0.13 percent), whereas in a different market environment, interest rates below 25 percent may already be seen as "aggressive rates" (e.g. peer group 4 percent, bank 4.9 percent). From a customer's point of view, the question probably is: what is the absolute difference in interest and is this difference worth switching deposits from one bank to another (considering the effort involved in opening new accounts / switching accounts)?

According to the DP, deposits that pay their return based on a market index should be treated as rate-driven. This proposal neglects the period in which the client does not have the right to withdraw their money. A term deposit with several years' maturity that pays an interest rate linked to an index is not necessarily rate-driven.

This is also the case for floating rate deposits. They are not rate-driven just because their basis is reset regularly. Their sensitivity depends mostly on the margin paid but not only on the floating basis.

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Q5. What criteria do you propose to address potentially higher outflow rates connected to term deposits?

We have difficulties in comprehending the rationale for assuming higher outflow rates in the context of term deposits. At this point, we do not feel that a differentiation is constructive. After all, this may trigger attempts to bypass this policy or could perhaps give rise to perverse incentives. In Germany, term deposits have a well established track record as a cash investment alternative which is appreciated also by clients seeking long-term investment opportunities. In terms of appropriate client advice and consumer protection, they offer higher product interest rates than sight deposits. Maturing funds often see an immediate prolongation. Hence, we do not subscribe to the statement on page 14 ("These products (…) appear to have the highest tendency of leading to outflows in stressed market environment").

Banks would refrain from offering time deposits if deposits with bullet maturities were to receive a less favourable treatment than deposits which can be withdrawn without any prior notice on a daily basis. Alternatively, banks may offer defensive conditions and thus shorten the funding of banks. This would result in rising liquidity risks for banks and the financial system. From the bank's point of view, particularly funds borrowed for one month would become pointless. Also clients who prolong their fixed-term deposits on a regular basis should not be subject to higher outflow rates. The danger that such deposits will be converted into sight deposits is already discussed in the current DP. We can only confirm that this concern is justified. Hence, we strongly advise against classifying fixed-term money by default as a deposit that is subject to a high outflow rate. In contrast, we believe an institution should set incentives to originate term deposits which undoubtedly provide stable funds to the bank for its tenor. It would be counterintuitive if such deposits were subject to higher outflows when they run into the 30-days period. On a portfolio basis, when such a portfolio of term deposits turns over on a regular basis, the risk of disproportional outflows is mitigated. In our view, the probability of deposit outflow mainly depends (i) on whether the customer is a single product user and (ii) it depends on the pricing of deposits. However, it does not depend on the (initial) deposit maturity.

We take note that the EBA recognises the danger of potential 'unintentional reclassification'. For this reason, there should be an in-depth analysis of the characteristics of this instrument in the individual European countries. As has already been mentioned above, on page 14, the discussion paper points out that these products feature higher outflow rates (cf. above). Accordingly, we take it that the corresponding data are available in order to carry out a precise analysis of the product features responsible for this behaviour.

We agree that "… any product innovation should therefore not only be in the legal documentation, but actually reflect practice." However, once such arrangements have been made, they should be fully accounted for the purpose of the calculation of liquidity ratios (unless they are called) .

Institutions should in any case have the right to a waiver if they can demonstrate that fixed term deposits do not have higher outflow rates.

Q6. What are the other characteristics identified capture the key attributes of retail deposits subject to higher outflows? What is the internal policy extended to detect other characteristics?

We believe that whilst there is some merit in analyzing such characteristics for the purposes of long-term liquidity management and stability, the information has no relation directly to the behaviour of such components under stress.

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On most other characteristics, there can be various counterarguments that dispute the direct relation between deposits qualifying for such criteria, and their assumed stability. Especially the financial crisis has shown that soft factors and negative headlines were partly responsible for a huge outflow of funds in a number of banks. Aspects such as e.g. "branch system", "personal contact" and "duration of the business relation" could be used as positive characteristics for classification as stable deposits.

Attribute 7 "sophisticated and high net worth individuals" is difficult to evaluate and is already covered in the sum total of the deposits under item 1 "value of deposits" . Hence, we feel that this characteristic could be deleted.

The characteristics of the discussion draft represent a thorough enumeration but should concentrate on the two or three main factors.

- Customer is single product user
- High volume deposit (considering DGS)
- Concentration risk

All other relevant influencing factors should be considered individually by each bank based on an individual risk assessment. Therefore, our internal policy comprises the option to assess other qualifying relevant criteria influencing the stability of deposits (e.g. franchise activities, business strategy, market competition, political/economical/regulatory environment).

The DP mentions "… For this purpose, institutions should conduct a stress test scenario assuming a combined severe idiosyncratic and market wide event. Internal statistical and mathematical models could be used to assess the volatility of retail deposit products. The inputs for these methods generally comprise data derived from the past behaviour of deposits and from hypothetical assumptions based on stress scenarios." The issue with the proposed approach is the following: All the available information from the past is already in the time series. There is no more information that can be retrieved from applying additional scenarios (the only thing it does is to evaluate a different outcome from that 'stability information', but it does not alter the stability information from the time series itself). Hence, all simulation comes down to the scenario forecast, which is more an assumption than a precise modelling. Any assumption will be difficult to be validated objectively. Maybe that is agreed by EBA, but the DP text suggests that there is a well-defined mathematical process to determine stability over various scenarios, which is not the case. So the 'expert judgement' will take a higher weight in such an analysis than it may read from the DP.

Q7. In your view are the descriptions applied to the characteristics and their analysis sufficiently comprehensive?

Whilst both the descriptions applied and the analysis provided is sufficiently comprehensive, we fail to see why these factors need to be analyzed in such level of detail, as their relation to the behaviour under stress is highly debatable.

The definition of "sophisticated depositors" or "high net worth individuals" remains unclear. The DP concludes that deposits by non-residents will generally be subject to a higher outflow factor (cf. criterion 6, page 15). Given the European single market and cross-jurisdictional solidarity which gained in importance as a result of the sovereign debt crisis and in view of the envisaged single rule book, all citizens who are nationals of a European Member State should be deemed "residents". As a result, the discussion paper should be amended to include a definition of the term "resident".

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The EBA sees the level of educational attainment ("sophistication") and client affluence ("high net worth", cf. criterion 7, page 15) as a trigger for a higher outflow factor. In our view, this statement discriminates less educated or less affluent clients in an unjustified manner. Furthermore, this language begs the question: How should these criteria be quantified? Notwithstanding the foregoing, especially less educated clients might be influenced to a greater extent by newspaper headlines and could, perhaps, withdraw their funds in a more fickle manner if there is a crisis. Hence, this criterion should be deleted.

"Product linked deposits" is another criterion which the EBA associates with higher outflows. In practice, deposits are often linked to funds or insurance products. Partly, they feature a very long contractual duration or, moreover, a very long investment horizon. As a result, this link should be investigated in greater detail and – if applicable – should be left to the discretion of the respective bank.

The paper differentiates between "internet-only banks" and branch-driven retail deposits which can be accessed via internet. Yet, the DP remains largely silent on how this difference is expressed in terms of outflow rates.

Besides this missing definition we do not agree that internet-only deposits necessarily suggest a higher outflow rate unless there is a statistical inference that internet-only banks attract a customer base with significant different customer behaviour compared to a branch-driven network. We would be interested to discuss this in more detail should the EBA have access to data which demonstrates this link.

Also the DP admits that the model is based on an analysis of historical data. Essentially, every crisis is unique featuring different characteristics. This means that [any crisis only allows limited conclusions concerning the] future outflow behaviour (c.f. page 9). As a consequence, a list of criteria should be developed for banks on the basis of which the decision in favour of higher outflows should be left to the banks' own discretion.

Q8. Is the threshold based on the guaranteed amount and the threshold of 500 000 EUR appropriate? If not what in your opinion could be the uniform benchmark for the thresholds?

Concerning the outflow behaviour, the local DGS or IPS present better threshold levels than arbitrary parameters (cf. Q3). As already suggested as an alternative under question 3, we believe a threshold of EUR 1mn or local DGS or IPS for deposits that may attract a higher outflow is sufficiently conservative. This is not only easier to implement, but also corresponds to its internal assessment of the behaviour of deposits under stress.

A harmonized threshold definition for deposits of retail clients and small and medium-sized enterprises would reduce operational complexity and should therefore be considered.

Furthermore, it could be appropriate to set an individual threshold for each bank depending on individual parameters like the total deposit volume concentration risk in the portfolio or the number of depositors.

Basically, what matters for depositors is the guaranteed amount of their local DGS or IPS. In our view, also in stress situations, a bank's credit rating only becomes relevant for depositors when this threshold is exceeded. Hence, the regulation should use this bank-specific threshold in a consistent manner.

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Q9. Is the definition of products with rate-driven and preferential features precise enough? If not please specify what additional specification would you include?

We believe that a product-by-product assessment of assumptions under stress solely on the basis of interest rates is too prescriptive and arbitrary for the purposes of a 30-day stress period as reflected in the LCR; also, it does not seem to be immediately relevant due to the reasons mentioned above.

Although we do not agree with all specifications, the definitions of the aforementioned products are precise enough (see also Q4 and Q18) .

Q10. Is it feasible to assess the proposed characteristics on robust operational grounds?

The operational capacity and feasibility of the characteristics suggested in the discussion paper is extremely precarious, if not impossible. Within the retail area, there are many different products and even more individual customers which makes the added value of such detailed assessments for the purposes of a 30-day stress period high debatable.

If the proposed approach has to be implemented operationally, this will lead to considerable implementation costs and a long preliminary lead time before steering mechanisms are changed and fully operational. Therefore, we suggest a cost-benefit analysis for all criteria followed by a prioritisation of the most relevant criteria which really represent a benefit in the risk assessment.

We propose to use only the criteria "concentration risk". Besides this criterion, an individual assessment of further criteria should be required by each bank adopting individual and adequate outflow rates.

Assessing the level of sophistication will be difficult. The other characteristics are appropriate but will require additional resources (see also Q11).

Q11. How much and what additional resources will be needed by institutions to implement this assessment? How much and what additional resources will be needed by institutions to run the assessment on an ongoing basis? Could you explain what will drive the costs (for instance, IT resources, additional staff, etc.)?

Not all banks will have the data readily available in their systems. Furthermore, for instance processes for determining interest rate-driven products require new computation algorithms which will have to be programmed and implemented accordingly. Besides, also the qualitative criteria (e.g. the criterion "sophistication") require the development of methodologies that will have to be maintained and integrated into the technical architecture. Hence, the implementation will tie up major technical and operational resources within banks.

Across the retail platform, costs would rise significantly as not only the operational burden of being able to capture the proposed characteristics is very challenging, also the negative outcome of this in terms of the LCR calculation compared to the Basel ratio will have implications on the retail business model and product placement. Furthermore, coverage of all criteria may incur higher costs for the bank. Also these costs would have to be factored into the cost estimate.

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Q12. Are there any other factors which appear to be associated with higher outflows on retail deposits? If yes, which factors? Please justify your answer.

We do not see any other factors useful to assess for LCR purposes.

One rather hypothetical criteria may be that customers may feel obliged to end their business relationship when an institution changes a particular business model or business region. Therefore, deposits from a non-core business should not be considered stable. Obviously, these scenarios will be rather to be considered on its one and not a characteristic to be considered under a going concern assumption.

Q13. Do institutions view the combination of any of these (or any additional) factors as more prone to lead to liquidity risks?

The factors presented under "9. Other characteristics" measuring the probability of an outflow constitute possible root causes for higher outflow rates. However, they can by no means be regarded as proven evidence for higher outflow rates. The outflow rate may especially be influenced by "positive criteria" such as the ones presented under question 12. Given the host of national idiosyncrasies, the heterogeneous investment behaviour of European citizens and the lacking predictability of future crises, a central European-wide rule appears to be extremely difficult. Based on the foregoing, we feel that bank-specific or at least national rules will be more feasible.

Whilst for individual clients and/or products, a combination of the described factors may indeed give rise to less stability, the operational difficulty does not weigh-up to capture these individual clients that can be factored in through a portfolio approach.

We agree that a higher concentration of the factors listed in the DP frequently translates into a lower product stability. However, some criteria seem redundant, e.g. sophisticated and high net worth individuals have almost "by definition" very high value depositors. Sophisticated and high net worth individuals shouldn't be used as separate criteria.

Q14. What is your opinion on the feasibility and resource-intensiveness of implementing the proposed methodology in your jurisdiction?

In terms of finance / staff, for banks and IT centres, particularly the implementation of the forthcoming qualitative criteria such as sophistication will tie up major resources. Furthermore, the question in how far top-down criteria lend themselves to a generic classification is still open to debate. Rather, when it comes to assigning higher outflow factors to deposits, banks should be given discretion to choose the methodology themselves. After an initial validation on the part of the national supervisor, the bank's rationale could subsequently be subject to regular audits and endorsements by the supervisor thus ensuring an appropriate level of quality.

There is a high degree of complexity in implementing the proposed methodology. This is due to the fact that it cannot be seen in isolation but has to be seen in the context of the 'full package' of new liquidity regulation, For example, data systems need to be enhanced to provide higher granularity data as well as additional information. Also, the implementation of the proposed methodology requires that internal systems are adjusted and brought into line with internal funds transfer pricing policies. For complex banks, this requirement is considerable involving a financial budget which can easily amount to 50-100m € with an implementation time of approximately 2 years.

We feel that the proposal is generally too complex and we doubt its practical feasibility as far as the subsequent questions are concerned regarding the determination of the outflow rates. Each client and each product of the client would have to be assigned to one of the categories specified. However, this categorisation would not just be a one-off exercise. After all, customer behaviour may be subject to change over time. For banks, performing a categorisation exercise in regular intervals is not feasible.

For less complex institutions, the implementation may be feasible with additional resources (see also Q11).

Q15. What is your opinion on the composition of the 2 groups of the characteristics ranked according to riskiness?

We have difficulties in comprehending the basic rationale behind this approach. For instance, especially term deposits lead to high outflow rates (cf. Q5). However, the current proposals fail to recognise further factors such as close customer relations or deposit protection thus ignoring their positive, mitigating impact.

Partly, the risk factors feature a positive correlation. This means that the presence of certain risk factors signifies that further risk factors are involved almost by default. As a result, the assumption of a higher outflow rate would be justified. For instance, in the justification for "value of deposit" and "depositors are sophisticated or high net worth individuals", by way of analogy, there is partly a predication on a more active management of deposits. In essence, many factors can be traced back to a more or less active deposit management; what is more, this may even be a risk factor in its own right. Hence, the likelihood of the simultaneous manifestation of more than one risk factor is highly likely. As a consequence, we feel that the threshold for the allocation to a given risk category (i.e. this threshold being two risk factors) is too low.

We believe that only deposits in excess of EUR 1mn should be subject to slightly higher outflow vectors of, for example, 15 percent.

Our historic evidence does not associate maturing fixed term deposits with very high risk factors. We regard the two characteristics "rate-driven deposits" and "concentration risk" as the most relevant risk factors. We would prefer to restrict the list of characteristics to the most relevant criteria. The proposed list is regarded as too complex in implementation and steering leading to high implementation costs.

During the past years of the financial crisis and stress the predicted high outflow rates have failed to materialise. Quite on the contrary: In Germany overall deposits increased. If the LCR already considers these high rates, we assume an even stricter approach in NSFR which does not seem to be appropriate. Our historic data indicates that retail deposits are a stable source of funding. This should be reflected in regulatory requirements.

As already mentioned, it should be made clear, that these additional criteria apply for non operational deposits only. Operational deposits should not be affected, i.e. non-resident deposits are not counted as very high risk if the deposit serves for operational purposes.

Comments "On retail deposits subject to higher outflows for the purposes of liquidity reporting under the draft CRR"

Q17. Do you believe it would be appropriate to allow derogations from the application of outflow rates on the basis of uniform strict criteria?

If the prescriptive approach as suggested in the discussion paper were to be implemented, the uniformity and comparability of result across institutions would be highly questionable as many factors include arbitrary and subjective components. Through a more simple differentiation (in line with the current proposals), there should be no valid ground for a derogation from the application of outflow rates.

In general, derogations from the application of outflow rates should be possible where economically justified.

The proposal should also consider the nature of the client relationship and the number of products used by a client: the longer the business relationship with the client exists and the more products the client uses, the lower the outflow probability. Additionally, the diversification of a deposit portfolio can lead to a stabilization of volume over time.

For instance, more likely than not, the [multi-]branch system, personal contact or longstanding business relations dating back several years will have a positive impact on outflow rates. At this point, we would like to provide an example: The client is a sophisticated, high net worth individual. He has been a customer of his local bank for the past 30 years. The local bank forms part of a deposit protection scheme. His main investments come in the form of fixed-term deposits. At the same time, he is a member of the bank. Hence, he has a vested interest in the sustainable development of the bank. This client may, additionally, be granted preferential terms and conditions. Based on the current proposals, the client would already have met two criteria of category 2 (fixed-term deposit + high deposit volume) meaning that the client's deposits receive an outflow of 25 percent. However, under the currently practiced LCR approach, this deposit would have been categorised as stable (deposit protection scheme; stable customer relations) with an outflow factor of 5 percent.

Hence, certain safeguards are required in order to ensure that certain "positive criteria" do not offset the "negative criteria".

(see also Q2, Q4, Q8 and Q18)

Comments "On retail deposits subject to higher outflows for the purposes of liquidity reporting under the draft CRR"

Q18. What are in your opinion factors that could lead to the application of the above-described derogation mechanism?

For example, on a group basis, where a subsidiary holds a portfolio of deposits, such deposits would be seen as 'non-resident deposits' from a group perspective, but they are resident from the subsidiary perspective. Therefore they should be treated 'stable' on a group basis given they fulfil all necessary characteristics for stable deposits at the level of the subsidiary.

If institutions can demonstrate that certain risk factors do not have explanatory power at this institution, they should be allowed to ignore these risk factors. To give an example: If an institution can show that adding a second threshold above the "normal" amount does not increase the accuracy of the outflow model, then it should be allowed to content itself with just one threshold.

Yours faithfully,

For the German Banking Industry Committee

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