German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

On EBA Consultation Paper "On retail deposits subject to higher outflows for the purposes of liquidity reporting under Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)" (EBA/CP/2013/34)

Contact:
Silvio Andrae
Telephone: +49 30 20225-5437
Telefax: +49 30 20225-5404
E-Mail: silvio.andrae@dsgv.de

Berlin, 13-10-01

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.

Coordinator:
German Savings Banks Association
Charlottenstrasse 47 | 10117 Berlin | Germany
Telephone: +49 30 20225-0
Telefax: +49 30 20225-250
www.die-deutsche-kreditwirtschaft.de

Comments “On retail deposits subject to higher outflows for the purposes of liquidity reporting under Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)” (EBA/CP/2013/34)

On 1 August 2013, the European Banking Authority (EBA) published its Consultation Paper on “Guidelines on retail deposits subject to different outflows for purposes of liquidity reporting under Regulation (EU) No. 575/2013 (Capital Requirements Regulation – CRR)”. We appreciate the present opportunity to share our comments.

I. General Comments

First, we would like to point out that we welcome the application of the 5% weight for stable retail account deposits. However, we propose waiving the need for a fundamental, comprehensive review of the seven risk categories for deposits which meet the precondition under Art. 421(1) CRR and to only request such a review if and when banks possess obvious evidence that – in the event of a market-wide and bank-specific stress scenario - the expected outflow rate for the respective deposit will differ from the 5% set out under the Discussion Paper’s current proposals.

Along with the aforementioned seven criteria, under Indent 13, the EBA seeks to oblige banks to review even further characteristics as to whether they indicate or might be used as measure for higher outflow rates in the field of retail deposits. To this end, Indent 13.1 to 13.7 lists numerous requirements which would incur considerable implementation costs. This relates to the implementation of the new data requirements during the identification of the risk factors at the level of individual transactions as well as the collation of a data history for the respective categories needed in order to calculate an estimated outflow rate. Frequently such data are non-existent on the level of the individual transaction or, moreover, on an aggregated customer level.

The implementation costs incurred will be particularly high, for instance, when it comes to using mathematical and statistical models, the consideration of correlation and contagion effects as well as the identification of products that lack either a stable historic volatility or an expected volatility. Whilst such models are partly already being used for the purposes of liquidity risk monitoring under Pillar II, they would still require further, considerable adjustments in order to meet the requirements under the guidelines. Furthermore, also the documentation and establishment of an audit-proof process would incur considerable additional costs within banks.

The proposal for calculating retail deposits featuring different outflows for all of a bank’s existing liability side products that serve the purposes of deposit taking business seems inappropriate to us. Our caveat is owed to the considerable implementation costs involved as well at the short implementation period which bears no relation to the gain in decision-useful information.

Such a comprehensive calculation of risk parameters is especially unrealistic for smaller banks with a business model geared to retail clients and SMEs. For the calculation of more volatile deposits, the EBA suggests using the deposit level (aggregated deposits per person) as a risk factor. We therefore suggest introducing an absolute fixed threshold that shall be based on the level of the deposits below which the test under Art. 421(3) CRR may be skipped.

Comments "On retail deposits subject to higher outflows for the purposes of liquidity reporting under Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)" (EBA/CP/2013/34)

In our view, the amount of additional liquidity outflows which could be identified by means of these models and which are not already covered by other criteria would be extremely low. In our opinion, this fails to live up to a cost-benefit analysis. Hence, we recommend deleting Indent 13 without any replacement.

Under Indent 14.5, banks themselves should estimate the outflow factors for the three categories that are subject to higher outflow rates. On principle, we welcome this proposal. However, due to the fact that the calculation of outflow rates for the three additional buckets according to the historical assessment clearly increases complexity, this could translate into disadvantages for a number of banks.

Hence, should a bank be incapable of carrying out the required calculations or if the calculation were to be economically unviable in light of a bank's retail deposit volume, supervisory authorities should stipulate (within the meaning of a "fallback approach") outflow factors, too.

Furthermore, we have concerns over the fact that the present Consultation Paper fails to adequately take account of national idiosyncrasies. For instance, Art. 421(3) CRR does not explicitly stipulate the consideration of local depositors' behaviour. A corresponding consideration of these national idiosyncrasies is entirely absent. These idiosyncrasies are reflected in the different macroeconomic framework conditions under the jurisdiction of individual Member States and the trust thus vested by deposit creditors into the respective national banking system.

Furthermore, we criticise the fixed buckets assigned to individual products. For instance, in our opinion the view that fixed-term deposits shall be deemed as inherently less stable deposits is untenable. Such a simplistic assessment completely ignores the option of a prolongation for these deposits. At this juncture, a more differentiated presentation would be helpful.

In the hearing held on 4 September 2013, the EBA expressed its view that – when it comes to the risk factors – it is not the deposits but rather the depositors who shall be considered. As a consequence, even the presence of risk factors for small fractions of the entire deposit would translate into a need to assign all the deposits to one of the three buckets. We explicitly disagree with this interpretation. The higher outflow rates should only apply to those parts of the deposits where the risk factors have been detected. Otherwise, there would be strong cliff effects. For instance a EUR 100,000 deposit eligible for an outflow rate of 5% would have to be assigned a higher outflow rate in its entirety if the customer made another deposit in a different account featuring risk factors.

We have difficulties in comprehending the reasons for a putative "spill-over" effect of the outflow risk upon the stable deposit assumed in the Consultation Paper. As a consequence of the ensuing cliff effects, banks might have to fundamentally reconsider their terms and conditions for stable deposits. The EBA continues to embrace a somewhat contradictory view given that - for the "established relationship" – the assumption is that a higher number of products translate into enhanced customer retention.

In addition, we would consider it inappropriate if possibly higher outflow rates translated into lower factors for calculating available stable funding for the NSFR. In our view, the time horizons and stress scenarios of the LCR and NSFR are not so comparable that a direct correlation can necessarily be assumed.

II. Specific Comments

Q1. Do you agree with these criteria for assessing the existence of an 'established relationship'? In your view, what other criteria could be considered to qualify deposits as being part of an 'established relationship making withdrawal highly unlikely' under a combined idiosyncratic and market-wide stress scenario?

Along with the definition of retail deposits which shall be subject to a higher outflow rate than 5 to 10%, the EBA also wants specify in greater detail the expression "established relationship" which reduces the likelihood of a withdrawal. In this context, the EBA proposes three criteria of which at least one needs to be met.

In our view, the duration of a business relationship constitutes a deposit stability indicator which is easy to monitor. However, an established business relationship should already be assumed if the customer maintains an ongoing account with the bank. In our view, such an account is already evidence of close customer relations making an outflow of funds in a stress scenario rather unlikely. One further possible indicator which, however, might be difficult to ascertain and could thus potentially incur greater complexity – would be the house or principal bank function. Last but not least, the assessment of a stable customer relation should be determined on the basis of harmonised criteria per customer, i.e. it should be assessed for each and any deposit in a uniform manner.

As well as the three criteria mentioned, further factors, such as the existence of a credit balance, could also be used. In this regard, however, only criteria which can genuinely be quantified and that lend themselves to system-side queries (e.g. the presence of members' capital contributions, minimum duration of the customer relationship of at least 2 years and use as a payroll account).

Furthermore, banks should be allowed to prove to the supervisor the existence of an "established relationship" also by other ways than those proposed by the EBA. One example would be that the equity based participation in a bank's operating business (for instance in the form of bonds such as profit participation rights, junior loans) can be seen as an expression of a high degree of confidence and close relations between the customer and the bank.

Q2. Do you agree with this criterion for identifying a transactional account?

The EBA identifies a transactional account on the basis of the criterion that it is the client's transactional account and that the customer's ongoing payment transactions are handled through this account. In our view, these requirements are but an inadequate reflection of the banking market's evolution in recent

Comments "On retail deposits subject to higher outflows for the purposes of liquidity reporting under Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)" (EBA/CP/2013/34)

years. Thus, nowadays clients generally tend to have several accounts which they use for handling their ongoing payment transactions; yet, they only tend to have one single payroll account. Hence, accounts should be identified as a "transactional account" already in the presence of one of the two criteria proposed.

Concerning the criterion that a "transactional account" shall be identified by historical data, in our view it should be deemed sufficient if a behavioural score exists for the respective client.

Q3. Regarding established relationships, how would you assess that the contractual relationship with the institution and the minimum number of products are active in the sense of being actively managed?

For identifying "established business relationships", the EBA wants to propose the criterion that the customer shall have a minimum number of active products with the institution. There may, in our view, be a possible link between the number of products used and the stability of the client relationship. On the other hand, some analyses by banks have also concluded that the number of products is no yardstick of stability. Conversely, even a single-product user with a sufficiently long-standing account may constitute a relationship stable enough to make a higher outflow of funds in a stress scenario unlikely. Extensive studies in some banks have found a very high level of stability after doing business for a period of only nine months. In this regard, the correlation of the two parameters is highly customer specific; hence, this correlation is not fit for purpose as a defining element. In the light of the technical implementation in terms of IT, on the whole, we view the use of two or more active accounts not as an appropriate criterion.

More specifically, in this context a more appropriate methodology seems to be the volume-based methodology discussed under Indent 6.

For assessing whether products are being actively managed, the following criteria might be used as indicators:

- The corresponding product category remains subsumed under new business acquisition;
- The product scores regular payment flows;
- Concerning the sales and / or process management, the product is part and embedded of banks' activities.

Q4. What is your view concerning the threshold proposed for high and very high value deposits? Please give your reasons.

The EBA proposes certain thresholds for high and very high value deposits. On principle, we share the view that there is a correlation between the total level of a customer's deposits and its sensitivity with regard to the stress scenarios. Having said this, in our opinion the definition of the threshold for high value deposits is a source for concern. This is due to the fact that any potentially higher coverage of these deposits through deposit guarantee schemes remains unconsidered, even if these deposit guarantee schemes, though established on a voluntary basis, are fully recognised by national lawmakers. However, especially the coverage of potential losses during crises has a far greater impact on the clients' sensitivity during stress scenarios than the absolute level of the depots. Hence, in our view it would be more meaningful to define high value deposits as such deposits which are not covered by a deposit guarantee scheme (statutory or voluntary). The threshold for extremely high value deposits should then be a multiple of this threshold for high value exposures (for instance, it could be modelled on the EBA proposal, i.e. a five-fold multiple). Furthermore, we take the view that it should be possible to exclude deposits covered by an effective deposit protection scheme from checks for any further risk factors since there is no pressure to withdraw such deposits even in the event of a crisis.

Furthermore, as a special type of deposit guarantee, we suggest recognising also institutional protection schemes. Institutional protection schemes are an important, additional factor which guarantees the security of customer deposits. Consequently, this should also be taken into account as an alternative criterion with regard to outflows in the case of very high value of the deposits (> 500TEUR).

Concerning the thresholds for categorisation as a high or very high risk, we suggest that the EBA model its definition on the threshold defining retail exposure positions within the meaning of Art. 123(1) lit. c CRR, i.e. EUR1 million. This threshold should be applicable at least for a categorisation as very high exposure. Below this materiality threshold, a categorisation as a very high risk would be incompatible with the existing measurement mechanisms e.g. of retail holdings. Contrary to the privileged treatment when it comes to determining counterparty risk, we also have difficulties in comprehending the stricter treatment of retail positions for liquidity purposes.

It is our view that the allocation of the risk factor and the allocation of a potentially higher outflow rate only apply to that part of the deposits which exceeds the forthcoming thresholds and we would appreciate a clarification to this effect. Otherwise this, too, would result in cliff effects (cf. also our general comments on this matter).

Q5. Do you agree with the criterion for considering a deposit to be rate driven?

We share the EBA's assessment that – also in crises - there is a link between a customer's focus on rates and this customer's propensity to change. Also the criteria proposed appear plausible. However, generally speaking, we have concerns over banks' capacity to identify peer banking groups and to compare different products within this peer banking group on an ongoing basis. In our view, it would be more productive if banks themselves were entitled to identify a product to be rate driven. Due to the fact that banks know their own funding costs, this information would be easier to establish; also, it would feature a greater degree of precision.

We also have concerns over the fact that rate decisions taken by the other banks in the peer banking group may potentially have a negative impact on the LCR ratio; this may, for instance, be the case if a bank does not emulate an interest rate reduction or if it only does so after a certain delay. In our view, this promotes a uniform behaviour within the respective peer group thus potentially further compounding emerging crisis scenarios during periods of stress. Hence, this criterion could even prove counterproductive with regard to the LCR’s key rationale - securing financial markets’ stability. Furthermore, it is not clear how supervisors are supposed to verify compliance or, moreover, non-compliance with this criterion. We hold the view that defining a peer group is a highly complex process. This complexity is compounded even further if this process has to take place in regular intervals, if market conditions are subject to fast change in retail banking and if the approach has to be agreed with national supervisors. Hence, it might be sufficient if banking supervisors were able to veto significant misconceptions or abuse.

Q6. Do you agree with the criteria to identify this risk factor?

The explanatory text lists a bank which conducts its customer transactions exclusively over the internet as one example for a bank which, due to higher risk distribution channels, should define higher outflow rates for its retail deposits. We hold the view that this definition is erroneous on various counts.

First, compared to other business models, this approach would result in a wholesale discrimination against a certain business model in the absence of any valid statistical basis for this. Even during the last financial crisis, in the retail banking area (individual) internet banks were able to post considerable inflows; this is completely inconsistent with the EBA's assumption expressed at this juncture. Hence, with regard to internet banks, there are no behaviouristic signs indicating any particular risk aversion on the part of customers. *In lieu* of the latter, the level of the deposit guarantee scheme and the country where the bank is domiciled have a decisive influence on customer behaviour.

Furthermore, focussing the LCR on the classical distribution channels would fail to reflect the development which the banking market underwent in recent years. One of the hallmarks of recent developments was that (alongside with the regular branch network) more and more clients adopted internet banking. This is also evidenced by a steadily rising number of electronic payment transactions.

Hence, there is no corroborating evidence for the theory that – in the eyes of the customer - an internet bank (due to its “virtual nature”) was *per se* perceived as particularly prone to crises. Last but not least, to many clients, banks that are active in more than one region with branch network clusters primarily in larger cities may appear similarly virtual as internet-only banks. Based on the foregoing, banks which use the internet as their sole distribution channel should not be coerced into subjecting their retail deposits to higher outflow rates.

Above and beyond this, the EBA suggests that banks differentiate between deposits denominated in foreign currencies and deposits denominated in local currencies on the one hand as well as resident and non-resident deposits. For reasons related to the overall nomenclature, we have major concerns over an inclusion of these two criteria and perceive a need for further discussion; After all, customer behaviour and consequently higher outflows not only depend on a single stress scenario in the country where the credit institution is domiciled. Quite on the contrary: Customer behaviour very much depends on the situation in the country of origin.

Comments "On retail deposits subject to higher outflows for the purposes of liquidity reporting under Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)" (EBA/CP/2013/34)

For instance, more likely than not, in the event of a revaluation of the foreign currency – i.e. if there was a "domestic currency stress" – there will be higher inflows. The same would be the case if there was an emerging crisis in the non-domestic banking market. Especially the most recent past has shown that this involves highly complex interactions. The generic definition of both criteria as risk factors does not reflect this complexity in an adequate manner. Given the proportion of such deposits, for most banks the question arises anyway whether the meaningfulness of the LCR for the purposes of liquidity management would significantly increase if these factors were included.

Q7. Do you agree with the above analysis of the cost and benefit impact of the proposals?

We explicitly disagree with the EBA's view that the proposed further differentiation of the outflow rates can significantly increase the meaningfulness of the LCR ratio whilst incurring but moderate costs.

First, there is a host of factors which, as has been pointed out, are partly also correlated with each other. This leads to a clear increase in complexity meaning that also the costs for preparing and controlling this ratio will most likely see an increase. This is further compounded particularly due to the fact that, following the collation of the risk factors (which partly cannot be calculated), a further algorithm becomes necessary for deriving the respective outflow rates. This translates into the need for a multi-tier calculation method.

Last but not least, the most recent financial crisis has revealed that the level of deposit guarantees as well as the country in which the bank is domiciled are of decisive importance for customer behaviour. Whilst, in certain sub-areas, the parameters and criteria presented in the Consultation Paper may indeed be extrapolated and thus, theoretically, available, during past real stress scenarios these parameters did not have an effect that would justify their reflection in the LCR calculation.

Q8. Please provide any evidence or data that would further inform the analysis of the likely cost-benefit impact of the proposals.

N/A

Yours faithfully,

For the German Banking Industry Committee

Dr. Martin Lippert Dr. Silvio Andrae