<u>FBF Response to the EBA Discussion Paper on retail deposits subject to higher outflows for the purposes of liquidity reporting under the draft CRR (EBA:DP/2013/02)</u>

The French Banking Federation thanks the EBA to consult on a matter that could substantially impact the Liquidity Coverage Ratio. The proposals regarding possible higher outflows on certain deposits seem to us very worrying and would need further thinking regarding relevancy and potential impact on banks' liquidity, as one month consultation period is a very short time to make any conclusion on such a proposal. We do have anyway great concern relating to those proposals we want to share with you below. Then you will find our general comments and our answers to your specific questions.

While the Basel Committee provides openings to possible higher outflows, we want to point out that **European Union is the first jurisdiction that envisages putting in place such measures**. The implementation of LCR is already a huge yard that do not need to be more complex at this moment and it could be very harmful in creating an uneven playing field, especially as regards liquidity.

Moreover we would like to remember that late 2011, banks showed the EBA historical data on retail deposits that proved outflows in a month were limited on retail deposits. Applying a 10% outflow rate already takes into account deposits that would be less stable than expected as this is a mean weight on a very large scale. **It would be valuable to have a feedback from EBA on the responses it got from the 2011 Consultation Paper on the very same subject.**

In our view, **only of the absence of established relationship** or transactional accounts should be taken into account to justify any higher outflow beyond the 5% or 10% run-off rates, in line with the CRR definition of "established relationship". Then we would rather invite the EBA to check the application of these principles within banks after the entry into force of CRR.

1- <u>General Comments</u>

<u>What we observe</u>

Too complex methodology...

The proposed methodology is quite complex and could lead to problems when applied. It will be a challenge to register and judge all the proposed characteristics on a group-wide level. The diversity of systems is huge and customer-wide information is not always readily available everywhere. One of the most difficult points in the framework proposed by the EBA is the fact that the combination of all factors has to be checked.

Even if available, the question remains how to collect data. As the implementation date for the CRD-CRR IV could be January 1st, 2014, banks will only get 6 months to develop and test their IT systems. This will not be feasible if the methodology is too complex.

Additionally, the remittance delay for liquidity data is 15 calendar days (as foreseen in the EBA Draft Implementing Technical Standards on Supervisory reporting requirements for liquidity coverage and stable funding). This is a very short timeframe which makes it very challenging to comply with all the other treatments requested as part of liquidity requirements.

The operational costs of implementation of the suggested methodology will be high since the method requires checking 10 characteristics and all the potential combinations of these characteristics. The added value of such an exercise remains limited, as the higher outflow for retail deposits should remain an exception to the rule.

We thus favor a simpler approach with only a few relevant factors. As a consequence, we think that the methodology should be drastically simplified.

Need for a more progressive and less penalizing approach...

The methodology leads retail deposits to be potentially weighted with a 15% to 25% outflow rate, whereas French banking Groups have never experienced such retail outflows rates, even during the crisis. We consider these rates towering for retail clients deposits: for instance, the 25% outflow rate is equivalent to the rate that is applied to a significant part of corporate deposits. Moreover, one should not ignore that higher outflow rates have the mechanical consequence to require institutions to hold more liquid assets in the balance sheet at the expense of other credits: and could harm the lending capacity of the bank to its customers.

National discretion versus maximum harmonization

As most of the main FBF banks are pan-European ones, we favor in general the maximum harmonization of rules implemented at the European level, for both financial (ensuring the level playing-field inside Europe) and operational (implementing different rules in different entities) reasons.

National discretions should be limited to cases in which the national supervisor has the knowledge of country-specific factors generating the risk of higher outflows.

<u>What we urge</u>

Considering the significant impact on European banks' LCR, the consultation process should be supplemented with **Quantitative Impact Studies** (QIS) specifically dedicated to the EBA proposals. This should not lead to a significant change of the overall calibration of regulatory ratios, as it would go beyond the mandate of EBA.

Besides, as mentioned in Article 481, European authorities should consider the *'international regulatory development'* in modifying the LCR parameters (such as the outflow rates that are applicable to retail deposits, as suggested in the DP). We are unaware of any other jurisdictions that are in the process of adopting higher outflow rates for retail deposits in their binding regulation applying Basel III. **We urge European authorities to avoid any "gold plating" on LCR, as this would have very detrimental consequences on the financing of the European economy.**

The scope of application of the EBA proposal should be made more explicit as applying to retail deposits in EEE countries only (and not to non-EEE country retail deposits).

Risk Factors should be simplified and limited in numbers:

- The open-ended 'Other characteristics' Risk Factor should be deleted. It is far too open as the bank has to prove the existence *as well as the non-existence* of other characteristics that may indicate a higher outflow rate ;

  Several suggested Risk Factors are extremely correlated which leads to artificially grossing up the score (High Value Deposit, Very High Value Deposit VS Sophisticated Depositor...or Currency and Location VS deposits from non-residents) ;
- There should be no stigma on term deposit. Considering them as less stable would create an incentive to favor overnight deposits that is quite paradoxical as it would mean that regulators prefer overnight deposits to term deposits!
- The DP should be redrafted to be in line with the final version of CRR regarding the threshold of €1mm.

Then:

- To be consistent with the objective of the Single Rule Book, cross border groups should not be at competitive disadvantage with non-cross border groups ;
- Similarly, banks that would have access to broader or longer historical data should not be at competitive disadvantage with banks that would not have those data ;
- It is essential that EBA discloses the evidence on which the 15% / 20% / 25% suggested outflow rates have been derived ;
- The governance for a national competent authority to adopt even more punitive outflow rates should be explained and detailed, notably to avoid any additional local gold plating (on top of a potential European gold plating).

2- Answers to specific questions

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?

As a preliminary remark, actual historical runoff rates that were recorded before the newly introduced binding Basel III requirements (capital, leverage, liquidity...) are not so relevant to apply to banks since they are now subject to far more demanding prudential requirements notably on liquidity. As a consequence, the potential outflow rates in a Basel III-binding prudential environment should be expected to be lower than the outflow rates observed in a pre-Basel III prudential environment.

Actually it would be valuable that EBA discloses the evidence it has collected from regulators and from the 2011 Consultation Paper, notably to determine whether those run-off occurred during the first month of the liquidity crisis. As previously said, the most difficult point in the framework proposed by the EBA is the fact that the combination of all factors has to be checked. This could raise the costs in identifying the deposits while not bringing clarity to the system.

We would prefer an approach based on empirical and business analysis. The benefit of this method is:

- to have run-off rates that make economic sense;
- to adapt the granularity of data according to the business specificities of each institution.

If data does not show a stressed period it is either because, the institution itself has not experienced a combined stress scenario or either that retail customers do not react quickly during the first 30 days of a liquidity stress period.

This is from our perspective an important issue to consider: retail customers might react during stressed period but not necessarily during the first 30 days.

The empirical based method should prevail for large banking groups which necessary experienced combined stressed scenario. Local supervisors should have the possibility to validate this principle.

We recommend defining *few* criteria in order to implement a simple and robust management tool and to be confident in the data quality and results.

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 do not identify any other risk factors. Innovative products are not creating a higher liquidity risk for the institution compared to other products.

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?

The EUR 100k floor should be substituted by the local DGS amount.

Defining a threshold that separate 'high' from 'very high value' deposits seems to us non-relevant too. In our opinion, a client-driven criterion that would identify 'sophisticated client' would be a far more explanatory factor than a balance-driven or product-driven factor. **Should higher outflow rate be allocated, 'sophisticated client' could be used as a criterion.**

Most often, retail deposits are the most diversified source of funding as balances are spread over numerous clients. We have no example of having a concentration in retail deposits. Our members have different methodologies to determine whether there is sufficient diversification. Usually, those diversification tests are easily passed for.

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

Again, this criterion does not seem relevant for an institution that has a long-lasting relationship with its customer. In that case even for a rate-driven product, the deposit will be sticky. Moreover LCR incentivize banks to collect retail deposits and adapt current products in order to have more stability during a 30 day-stress scenario. EBA's proposal is inconsistent with this general incentive from the Basel text.

An innovative product will be less sticky if the bank is a new player on the retail deposit market for example or when the customer has only one product with the bank. But when the bank has an established relationship, there is no rationale to penalize innovative products or term deposits or rate –driven deposits with higher outflows rates. Once again, client-driven factors are more valuable than product-driven factors.

Concerning the definition proposed of rate driven deposits[1], we consider that:

- it is not possible to industrialize a solution where the output depends on the rate proposed by our peers. Indeed, these rates are not available in a way they can be treated easily ;
- the criteria could be based on a market index, but should be more clearly stated: we think a possible criteria would be "the rate offered to the client is close to the one offered to products sold on the market for similar maturities".

Considering the current low level of interest rates, the percentage-based 125% threshold should be complemented with an *absolute threshold*, such as:
client rates > maximum(125% x benchmark rate, 1% + benchmark rate).

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

It is unclear whether the higher outflow rate may apply or not to all fixed term / notice period deposits or only to the one that mature in the next 30 days.

In fact we do not identify a significant different behavior for term deposits; therefore they should not be stigmatized as being more risky than overnight deposits. Our analyses show that **all the deposits from a client should be analyzed as whole**, as the client may switch from one product to another **without changing its global deposits in the bank.** That is one of the reasons why we recommend not stigmatizing term deposits. Once again, client-driven factors are more valuable than product-driven factors.

Finally a bank which has diversified funding sources will be more resilient when experiencing a combined stress scenario. A higher outflow rate on some specific products will prevent banks from collecting stables source of funding and hence prevent them from financing the real economy.

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[1] This definition is "In case an institution offers an interest rate that exceeds the average rate for similar retail products offered by their peers by 25% (relative), or whose return is derived from return on market index or set of indices or other market variable than a floating interest, rate a deposit should be considered to be rate driven."

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 do not identify any other risk factors. It is very difficult, if even possible, to prove the non-existence of something; the task given by EBA to the institutions would be very difficult to fulfill and would probably never give satisfying results. We have by the way the same problem with the task given to the institution by article 408(2) of CRR, requiring institutions to estimate the volume of other outflows not specified by the regulation.

Moreover, this measure would be costly (in terms of staff needed to do such analyses, on a recurrent basis), with no specific reason since it is not known whether there should be any other deposits that should suffer from higher outflow rate is not yet known.

Our business is to build long, lasting and extended relationship with our clients, notably our retail client, by serving their needs as comprehensively as possible.

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

We would welcome EBA to illustrate with specific example the definitions:

- High risk distribution channel: internet-only banks will be the banking of the future. There is no rationale to penalize these activities. All banks offer internet services: why internet only banks would have higher outflows rates? Internet-only bank might give services which are more innovative and hence will create a better relationship, because of a better service. Moreover, cash transfers by internet are generally capped by amounts.
- Currency of deposits/location of the deposits: EBA agrees that this criterion can concern some jurisdictions but not all. What is the rationale to consider this criterion for all jurisdictions? We recommend EBA to analyze internal stress testing of institutions with local supervisors before setting up constraints that have not been proven.
- Product-linked deposits: EBA gives only one example which exists for private banking customers. Since we consider private banking customers as a separate category for our internal stress testing, we see no need to consider this risk factor.

Moreover, we observe **some potential redundancies** between factors:

	Factors :	Redundant with :
High risk factors	Currency and location of deposits	- Non-resident deposits
	Product-linked deposits	- Depositors are sophisticated or high net worth individuals
	Products that are rate-driven or have preferential conditions,	
	High risk distribution channels including Internet only access and brokered deposits	
	Depositors are sophisticated or high net worth individuals	- Non-resident deposits - High or very high value deposits
	High value deposits	- Depositors are sophisticated or high net worth individuals - Non-resident deposits
	Other characteristics	
Very high risk factors	Maturing Fixed Term or Notice Period Deposits	
	Non-resident deposits,	- Depositors are sophisticated or high net worth individuals - High or very high value deposits - Currency and location of deposits
	Very high value of the deposit	- Depositors are sophisticated or high net worth individuals - Non-resident deposits

<u>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?</u>

The EBA proposes to treat differently retail deposits according to their amount: from EUR 100k to EUR 500k and from EUR 500k to EUR 1m.

A threshold would need to be substantiated by evidence: it would be valuable that EBA discloses the evidence it has collected from regulators and from the 2011 Consultation Paper to suggest that a breakdown by balances has been evidenced as leading to higher first month outflow rate. It should be noted that the Basel Committee does not envisage a limit to deposits from natural person.

Besides this proposal seems to take for granted that the EUR 1m threshold will be maintained in the last version of CRR liquidity. It should be checked as the EUR 1m now refers to credit and not longer to deposit.

We strongly favor a definition of counterparties which is more aligned with the actual organization of bank institutions and with the nature of the clients the bank has to manage. Hence, we do not favor the maintenance of such thresholds to define retail deposits and to split them between less stable and more stable deposits.

We think the criterion "sophisticated clients" mentioned below would be enough to define the category of retail deposits that is more volatile.

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

Our analyses show that **all the deposits from a client should be analyzed as whole**, as the client may switch from one product to another **without changing its global deposits in the bank.** That is one of the reasons why we recommend not stigmatizing term deposits. Once again, client-driven factors are more valuable than product-driven factors.

The term "preferential conditions deposits" is not defined precisely enough to be applicable.
We would welcome EBA to illustrate with additional examples. Again, benchmark should be given by EBA.

Considering the current low level of interest rates, the percentage-based 125% threshold should be complemented with an absolute threshold, such as: client rates > maximum(125% x benchmark rate, 1% + benchmark rate);
This could serve as the simpler definition of 'rate-driven and preferential features'.

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

The timeframe has not allowed a cost and feasibility study. Yet, we expect it would be very challenging to collect the data to assess the proposed characteristics. Studies on aggregates would be preferable to a client level study.

The EBA has to check the feasibility especially for smaller institutions. The cost of implementation is expected to be too important and those institutions will utilize approximations instead of robust IT solutions. These factors require long studies in all our entities with different IT systems, with different local market conditions. The banks have to interpret this type of definition and translate them into easier characteristics.

We believe the more granular information is requested the less data quality will follow, and hence the initial objective of EBA will not be achieved.

We recommend that EBA first simplifies the scorecard as described above, and then launched specific QIS's in order to determine the assessment robustness and the impacts of the proposal. QIS's should be allocated enough response time for banks to be able to deliver reliable data.

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.)?

It will be challenging to register and appropriately assess all the mentioned aspects on a group-wide level. The diversity of systems is huge and customer-wide information is not always readily available everywhere. The cost will therefore be mainly IT driven but not only; additional staff would be also required to run this assessment on an on-going basis and ensure the system maintenance, an efficient control of the data and the data consolidation on a group-wide level (see general comments *"Too complex methodology"*).

We would estimate at least 2 years to implement this assessment for the main entities. We would like EBA to compare this complexity and resources consumption to the amount of potentially concerned deposits.

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 identify any other risk factors than client-driven risk factor: established relationship factor and sophisticate client factor.

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

As previously said, we favor a more simplified, easily understandable and operationally implementable methodology based for instance, on the definition of a new category of retail deposits for which applies a higher outflow rate. This new category would cover all the retail deposits that are not assigned to the categories weighted with a lower outflow rate, rather than the usage of multi-factor combinations.

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

As mentioned in the general comments (*"Too complex methodology"*) the proposed methodology would require costly development in the IT systems and additional staff to collect the required data.

On a 'run-mode', there will be no alternative than using operational shortcuts to deliver LCR within the remittance period that is envisaged by EBA (15 days in running mode).

See also answer to question 11.

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

We believe that there will a major level playing field issue between institutions and even more with jurisdictions that either does not apply Basel 3 or apply Basel 3 but sticks to 5% or 10% run-off rates for retail deposits. The implementation of such combination of risk factors will imply:

- risk of unavailable data at the entity level due to the high level of segmentation ;
- poor data quality due to the combination of risk factors ;
- uneven playing field between institutions.

Should there be a scorecard approach to allocate higher outflow rate to retail deposits *not* covered by a deposit guarantee scheme, *or not* coming from transactional account or where the depositor *does not have* an established relationship with the bank, we would suggest an *add-on* approach. As an illustration, deposits from clients with which the bank has *no* established relationship or clients that are deemed *sophisticated clients* could be added an *incremental* 5% outflow rate

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

It is not clear to us whether these derogations lead only to increased outflows or if they can go both ways (increase or decrease). Pan-European banks favor in general the maximum harmonization of rules implemented at the European level, for both financial (ensuring the level playing-field inside Europe) and operational (implementing different rules in different entities) reasons. But it should be possible to depart from a one-size-fits-all approach. However, the governance to apply for and validate the departure should be clarified. As an illustration, banks should be able to apply for specific treatment if they provide material to substantiate their proposals. If derogations should be considered, internal model approach should be considered by EBA for all institutions.

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

National discretions should be limited to cases in which the national supervisor has the knowledge of specific country-specific factors generating the risk of a higher outflow. As stated in the EBA guideline, the criteria mentioned by EBA are not clear enough and leave too much room for interpretation to the national supervisors.