



POLISH BANK ASSOCIATION

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Polish Bank Association respond to EBA Discussion Papers

I. "On retail deposits subject to higher outflows for the purposes of liquidity reporting under the draft Capital Requirements Regulation (CRR)"

General remarks:

Polish Bank Association welcomes the efforts EBA is undertaking to harmonise the approach for retail outflows in Europe, as this enhances the level playing field. We appreciate the challenge for the EBA to reconcile both differences on definition of deposits and determination of outflow rates.

We think that the outflow rates system proposed by Basel already considers higher outflow risk of some categories of retail deposit (the not stable one). Banks in Poland did not observe outflow for their own institution during the crisis. Therefore we believe the current suggested regular outflow rates are appropriate and do not require further increase.

We believe that the conditions set out in article 409.1 are already sufficient to ensure the stability of retail deposits, materialised by the outflow rate of 5%, and we suggest excluding them completely from the scope of the EBA methodology. Retail deposits that are covered by a Deposit Guarantee Scheme, which are either part of an established relationship making withdrawal highly unlikely or held in a transactional account, should not under any circumstances be subject to higher outflows (15%, 20% or 25%). It is not logical that retail deposits that have already been defined as "stable deposits" by the Capital Requirement Regulation (CRR) will not be regarded as such if they comply with a set of risk factors.

In our opinion the proposal put forward by EBA in this Discussion Paper is too complex. This complexity will be felt particularly strong during the development of the required IT systems and it will also be felt by clients. The intransparency of the requirements will translate in intransparent behaviour of banks toward the various groups of 'less stable deposit clients', which might be reflected in intransparent pricing as well.

The weak point of the proposal is the unclear treatment of deposit of small and medium enterprises in Discussion Paper.

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?

The level of granularity of available data and the length of observation period of existing customers behaviour are sufficient to deliver analysis on (a) characteristics of deposits subject to higher outflows and on (b) estimators of higher outflow rates. In our opinion historical data, especially including the period since 2008, is the most reliable source.

However, in our opinion the general challenge is that all historic data available until now do not indicate any unexpected or unmanaged outflow of deposits, even though the recent financial crisis. In contrast, overall deposits increased during the worst period of last financial crisis in the world. Particularly, we in Poland have such experience since 2008. So it is the main reason why we treat the task as very difficult to calibrate properly or to validate to hypothetical stress scenarios with significant outflows.

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?

Currently, we are identifying no other factors.

We would like also to stress once again that the factors indicated in Discussion Paper should be considered only in cases where deposit values are above DGS amount and the client is himself seen as volatile. In other situations the deposits should have the standardized outflow rate.

Looking at the proposal of characteristics identified by EBA the link between the currency and the stability of deposit is not obvious. We have the recent experience of outflow of deposits abroad from the euro zone countries and these deposits are held in local currency. It would be reasonable to look once again to investigate if such link exists in fact in recent history of banking sector in Europe.

We can also indicate the factors which should reduce the risk of deposit instability and diminish the rate of outflow. The good example can be the use of deposit as collateral for other services provided by bank. Deposits used as collateral for loan contract does not bear the risk of outflow until maturity of the loan.

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 using local DGS amount as threshold is justified and its current application in LCR framework (i.e. to distinguish between 5% and 10% outflows) is sufficient. Apart from the relation with DGS amount, deposit volume is not considered as an additional risk factor, nor significant dependence on it was observed during the crisis. Moreover, additional divisions based on the volume, especially using fixed amounts, may cause incoherence (e.g. in Poland DGS amount equals EUR 100.000).

Within the framework of concentration analysis we investigate the distribution of deposit base regarding the levels of deposits and calculate concentration indicators, i.e. Gini coefficient. We analyze also deposit base concentration split by depositor's category (individuals, small enterprises, corporate), and 3 total savings value / per client levels. Also in each depositors' category we monitor the part of total deposit basis represented by 1 single and 10 biggest deposit holders. We have warning thresholds assigned to these shares.

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

The majority of banks do not agree, mainly due to the following doubts:

- We did not observe significant dependence of deposits stability on price. For price-sensitive deposits, adjusting the price (in line with the market changes) may in fact be used to prevent the outflow;
- Comparison with peers is not possible – no reliable data are available (especially for deposits with negotiated rate);
- We did not observe higher outflow rates for products related to market indices.

Some smaller banks indicate, that it is true that during market-wide stress the level of price competition tends to increase and rate-driven deposits (as more sensitive to prices) can be less stable but ONLY if their current interest rate is LOWER than offered by competition. If rate-driven deposits are still more attractive (in terms of their price) there is no need to assume their higher outflows.

It's true the high rate deposits can represent excess funds that can be easily withdrawn in stress time but that outflow would rather apply for amount exceeding DGS amount.

Retail deposit prices (at least in Poland) are not directly linked to reference rates on yield curve. That was proved during 2008-2010 crisis and is observed currently. Therefore comparing deposit rates to reference rates is not proper. It is suggested that institutions should compare offered deposits rate to rates offered by their peers. If the peer group is correctly identified, finding any significant differences in offered rates would be surprising, as peer institutions most likely apply similar strategies. The most relevant benchmark is average retail deposit rate published by Polish Central Bank. It is important to note that some deviations from average rate are build-in banking sector, therefore limit identifying high rate deposits should be set high enough (and probably separately for each member country) to indicate real outliers offering highest rates.

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

We propose following criteria: cost of withdrawal of deposit, length of notice period and length of original maturity of deposit. However, current approach in the LCR where DGS amount is to distinguish between 5% and 10% outflows is in our opinion sufficient.

It is not clear to us why there would be observed higher outflow from term deposits than from saving deposits. To observe higher outflow from term deposits, early termination rate should significantly increase or/and roll-over ratio should decrease. Both are possible but we are not sure why it is thought to be more likely than outflows from saving accounts. We believe early termination of deposits might occur however more likely for high value deposits (exceeding DGS amount) and this issue would be covered in High Value Deposits paragraph.

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 contradictory, if such deposits would be subject to higher outflows when they run into the 30-days period. So, we believe that charging term deposits on regulatory grounds seems to be counterintuitive to the whole purpose of the using the LCR methodology which is to increase liquidity stability of the institutions.

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?

Currently, we are identifying no other characteristics. We do not have any new proposals. We avoid separate analysis of stability of different categories of deposit products because we assess stability of our deposit base basing on historical volatility data. Based on historical observations, we are convinced that the pricing policy performed by the bank in the past, highly influence the stability of specific deposit products but did not impact significantly the total deposit base stability (just internal flows between different deposits products). In such a case separate analysis of stability different deposit products, based on historical balances volatility, would produce misleading conclusions underestimating bank's deposit portfolio stability.

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

Yes, in our view the description of characteristics is generally of sufficiently wide scope. However, The definition of “sophisticated depositors” or “high net worth individuals” remains unclear. A common feature of these clients is that they conclude with their bank a mandate of wealth management, whereby they leave a degree of discretion to the bank regarding the investment policy and the choice of the investment products.

The paper differentiates between “Internet-only virtual banks” and branch-driven retail deposits which can be accessed via internet but does not state clearly how this difference is expressed in terms of outflow rates. Beside 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. In case that the underlying data the EBA has access to shows such evidence, we would be interested to discuss this in more detail. Given that also in branch based retail banks the majority of accounts can be accessed via Internet this criterion seems not to address the underlying risk factor. Again, we believe the number of products and thus the deepness of relationship between bank and customer is a good indicator for stickiness of deposits. Single-product, (rate driven) deposits generating Internet banks typically have no or only a limited relationship to their customers and therefore possibly see a lower stability of their deposits.

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?

We think that this threshold should be stressed locally based on internal analysis and its value should relate to the bank balance sheet total. However, the delimiting the High Value deposits (below EUR 500,000 and greater than EUR 100,000) and the Very High Value deposits (greater than EUR 500,000 and below EUR 1,000,000) is somewhat artificial as it is not representative of the customers’ behavior.

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

Yes, we understand definition of these products, but we definitely does not support the proposed way of selecting it from total deposit base (benchmarking conception) - see answer Q4 above.

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

Most of the proposed characteristics can be assessed. Most of the data falls within standard CRM information perimeter, however significant changes in IT infrastructure and business processes would still be required, e.g. concerning rate-driven or product-linked deposits. The characteristic: “product linked deposits” in respect of identifying detailed linkages between deposits and other products may cause some data problems.

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.)?

Performing this assessment will require the work of people from analyst, business and IT departments. Providing the assessment on an ongoing basis is less labour consuming. The most cost-driven tasks involve identification and gathering sufficient data, so additional staff for analyzing database and building IT infrastructure is needed.

Required changes would undoubtedly include:

- new business processes (e.g. analysing client behaviour under new criteria) – additional staff;
- significant changes to IT systems (including new flags for some characteristics and enriching reporting flows with new and existing information) – IT resources;
- new flow of information concerning peers (if possible) – IT resources & additional staff.

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 are identifying no other important factors. We may however recommend the EBA the position of bank as the additional factor. The banks which are treated as the SIFI can expect the smaller deposit outflow rate than the smaller financial institutions. This factor may be important but it generate the problem of level playing field in banking sector.

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

From our experience the rate-driven products, ones having preferential conditions and high value deposits can be to some extend prone to lead to liquidity risk.

However, generally we do not support using other proposed criteria as factors yielding higher outflows, for the following reasons:

- The value of the deposit (High value deposits and Very high value deposits)

See answer to Question 3

- Products that are rate-driven or have preferential conditions

See answer to Question 4

- Maturing Fixed Term or Notice Period Deposits

All term deposits not protected by loss of interest are subject to 10% outflow which is considered sufficient. As Retail deposits are managed on stock basis and not for single transactions and most term products have automatic rollover, distinguishing such a subcategory is not considered justified.

- High risk distribution channels including Internet only access and brokered deposits

We did not observe significant dependence of deposits stability on distribution channel, especially brokered deposits.

- The currency and location of deposits

We did not observe significant dependence of deposits stability on currency. Customers tend to keep savings in FCY in order to diversify between currencies and

not banks, thus in case of crisis the currency is prone to change and not the bank where the money is kept.

- Non-resident deposits

We did not observe lower deposits stability for non-resident deposits.

- Depositors are sophisticated or high net worth individuals

We did not observe lower deposits stability for such clients. Having a dedicated relationship manager is rather perceived as having an established relationship with the customer.

- Product linked deposits

We did not observe lower deposits stability for such deposits. Linking different products and increasing cross-sell is rather perceived as having an established relationship with the customer.

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

In our opinion, implementing the proposed methodology is feasible with some additional resources described mostly within the answer to question 11. In some cases, the methodological weakness of proposed approach, based on too much assumptions, may lead to incorrect estimation outflow expectations, what in our opinion, does not justify scale resources required for assessment implementation.

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

Without quantitative assessment of the real impact of this characteristics we can not give an opinion on the composition of the 2 proposed groups. However to obtain such historical data and check the outflow rate can be very difficult and can require intervention in databases and systems, which may prove to be too time-consuming or even impossible. Moreover in some factor cases (i.e. Maturing Fixed Term) the historical volatility of

respective products would be hard to define and highly influenced by bank's pricing policy changes during the past period, i.e. how to define roll-over Maturing Fixed Term Deposit: just roll over into same tenor as previous, roll-over for any fixed term deposit regardless the period or perhaps roll-over into any other deposit product in bank's offer? In fact even in the last definition bank did not experience any deposit outflow – just change of the structure of its deposit portfolio. Taking first or second strict roll-over definition, would lead to misleading information on bank's total deposit base stability.

Looking at the Table 2 on page 18 we would like to express our view that the EBA proposal can cause the double counting. If a retail deposit meets two criteria in category 1 and one from category 2, it is automatically considered a "very high deposit". However, in cases where category 2 criterion 3 is true, criterion 5 of category 1 will automatically apply as well. This is possible double counting, which does not make sense (unless EBA was aware of this and hence requires two of the indicators in category 1 to be true).


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 fully and reasonably argued in respect of e.g. exceptionally specific market, derogations should be allowed. However, we would like to stress that in our opinion current approach in LCR framework (with 5% and 10% outflows) is sufficient. Outflows of retail deposits observed during recent crisis periods were significantly below 10% both for the Polish banking sector (based on available data). Application of higher outflow rates seems more appropriate in exceptional market conditions or for exceptional jurisdictions (e.g. defaulting countries), where extreme scenarios are more justified and incentivising banks to maintain extra liquidity is more crucial.

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

These factors may consist in exceptionally specific market conditions, as indicated in our response to question 17. We would like also to add that the process to apply for a derogation should be made in clear way, notably that banks can apply for such a derogation.

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 fulfill all necessary characteristics for stable deposits at the level of the subsidiary.

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