BBA Response to EBA Discussion Paper: retails deposits subject to higher outflows for the purposes of liquidity reporting under the CCR

Introduction

The British Bankers' Association ("BBA") is the leading association for UK banking and financial services for the UK banking and financial services sector, speaking for over 220 banking members from 60 countries on the full range of the UK and international banking issues. All the major banking players in the UK are members of our association as are the large international EU banks, the US banks operating in the UK and financial entities from around the world. The integrated nature of banking means that our members are engaged in activities ranging widely across the financial spectrum encompassing services and products as diverse as primary and secondary securities trading, insurance, investment banking and wealth management, as well as deposit taking and other conventional forms of banking.

The BBA is pleased to respond to this consultation.

Key messages

<u>Need for flexibility</u>

While we understand that the EBA is obliged to develop guidelines and minimum standards with regards to liquidity reporting under the CCR. While we fully support this objective, an overly prescriptive framework which does not allow for a certain degree of flexibility could lead to problems for firms in meeting the reporting requirements. Furthermore, we consider that the proposals around data capture and statistical analysis are disproportionately complex for small firms and make no allowance for the limited nature, scale and complexity of their business or for the minimal risk they pose to the system.

An example of this is the table outlining the methodology for determining the outflow rate under 4.3. We accept the identification of "high risk" and "very high risk" factors outlined in table 1. However, the strict adherence to the characteristics laid out in table 2 for deciding the outflow rate may not accurately reflect real areas of risk. It does not take into account the risk levels of each individual factor, or how a combination of certain factors might lead to greater or lesser degrees of potential contagion risk, which could the affect what final outflow should be. While we agree that the factors listed in the table are important, due consideration needs to be made for any idiosyncratic features and issues relevant to the individual factors, and the varying impact they may have on different firms' business models.

Consideration also needs to be given to the nature of both the client and the product in each individual case. It is clear that some clients will be far more stable than others, and the same applies to products. Firms need to be given the scope to identify these differences and apply their judgement to ensure the outflow rates are proportionate to the stability of the customers and products in question.

For example, while deposits held as part of an investment portfolio under the discretionary management of a firm might display some of the characteristics identified as tending towards higher risk of withdrawal, in practice it is their link to the investment mandate that would tend to drive their behaviour. During the financial crisis, wealth management firms were significant beneficiaries of cash withdrawn from deposit taking firms perceived to be at risk. Given the zero sum nature of cash in the system, it could be misleading to assume that all high value and very high value deposits would have the same level of vulnerability of withdrawal in every institution. Context is relevant and one size does not fit all.

Outflow rates

We believe the outflow rates outlined in the paper are too prescriptive, and in many cases are too high. An outflow rate of 25% is very high, and the conditions needed to reach this level as outlined in table 2 of the response in many cases would not justify an outflow rate of 25%. Additionally, the outflow rate increases in increments on 5%; there will be circumstances where an increase of 5% has been triggered, but in practice it would be more equitable for the increase to be lower, for example, by 1% or 2%.

Data reporting and analysis

The discussion paper refers frequently to data, both in the sense of what is available to firms and regulators, and to what extent this data can be useful. This issue of the availability and analysis of data is an important one. At a high level, the data of firms in this space can generally be used for high level regulatory benchmarking, and to a lesser extent firm-to-firm comparison.

However, when data is requested on a significantly more granular basis for more detailed analysis, this can be problematic as firms' data will not necessarily be collected and presented under the same methodology, so will not be suitable for a like-to-like comparison.

By the way of example, the FSA encourages banks to report profiles of their own risk appetite to which both the firms and the regulator can offer an opinion. While we acknowledge this would not be a suitable course of action in this case due to the need to adhere to the CRR, we believe it would be beneficial to allow firms to provide some further expansion on the data they will report. The regulations should define the minimum standards that need to be met, but the mechanics behind the calculation of the LCR will vary from firm to firm, and it will be beneficial to allow further details and explanation to be submitted in order to ensure the data is fully understood by the regulators.

Cost of implementation

Our members have good coverage of the data in the sense that it in enables them to identify the retail deposits and set the appropriate outflow rates. However, firms do not have access to data at the level of granularity that is being asked for in this paper. In order to achieve this depth of data management, firms will need to invest significant resources into redeveloping their systems. We are not convinced that the benefits derived to either the regulator or the firm will be sufficient to justify what will in many cases be an expensive upgrade.

Meeting the objectives of the LCR

As we understand it, one of the key outcomes of the development of the LCR is to assess each bank's coverage of the liquidity buffer, rather than to provide the basis for a peer group comparison. Assuming the former is accurate, we would recommend as a general policy objective it would be prudent to keep the required reporting of outflows to a minimum, and at a relatively high level, and develop a process where firms could provide further explanation and details through the Pillar 2 and Pillar 3 mechanisms.

Conclusion

Our key concern is that firms are allowed to use their own judgments and expertise under a suitably flexible framework to ensure the outflows reported are an accurate representation of the stability of their retail deposits. This would not only provide regulators with better data, but it would also provide proportionality that will essential to smaller firms.

Annex 1 to this letter contains our formal response to the questions laid out in the consultation. The BBA would be very happy to further assist the EBA in relation to the above.

Yours sincerely

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Annex 1

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?

Firms would need to develop their systems to achieve the extra granularity required, the cost of which would not justify the further expenditure (see key messages above).

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?

The factors outlined in the paper provide a good coverage of those that could potentially lead to higher outflows.

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?

This matter should be a function of the local DGS. To clarify, if it's a subsidiary it will be out of scope, while a branch will be regarded as in scope.

The key issue is the need to focus on the amount that is actually insured; for example, in the situation of a joint account, account of the total amount insured should be acknowledged.

In regards to the high and very high value deposits, we are of the opinion if all products deposited by the clients over 500 000 EUR are automatically decided to be of very high value, this could have a disproportionate affect on private banks, where many of their clients will meet this criteria, and will as such will have a very high number of outflows at 25%.

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

The criteria outlined in the paper are acceptable although we believe that "internet only" accounts form a higher rate deposit. However, there are potential difficulties concerning the changes in rates over time; there needs to be further guidance on how often the relevant rate will need to be reviewed.

The implementation of this rule could also prove to be problematic in practice. For example, each bank will have a different internal view as to what they consider the definition of rate driven to be. It is the relativity of rates that is important.

Another potential issue is inter-bank comparisons; a product that a tier one bank considers as being rate driven might differ from that of a very small bank. At the moment it is a subjective test which could lead to unpredictable outcomes.

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

We believe there is a difference between a maturity term deposit (which may roll) and a "maturing" notice account where the customer has actually given notice. In the latter case it is clear the customer intends to withdraw the funds, but not so in the former case.

Term retail deposits can be rolled over either onto another term product or onto call accounts. The issue, of course, is the customer's need for the cash, in normal circumstances, and their propensity to leave the money with the bank in a crisis. Historic data can be used to determine the roll over propensity of a term deposit in the same way it can be used to determine the likelihood of a call deposit remaining with a bank.

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?

The current policy followed in order to detect other characteristics and significant points of interest is to discuss the data with FSA, primarily through the use of an ILAA.

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

We are satisfied the analysis is sufficiently comprehensive. However, the proposals give insufficient consideration to the different business models of firms, in particular those with deposits linked to discretionary investment management. While free-standing deposits placed by sophisticated or high net worth individuals may on the face of it appear to be volatile or fugitive, this does not necessarily follow when they are held as part of an overall investment portfolio managed by the firm. Experience in the financial crisis showed large inflows of funds to investment managers at the expense of mainstream banks.

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?

Balance banding is one possible way of splitting retail customers' balances. However, choosing where to draw the line is not straightforward as liquidity behaviour is a continuum. That is why we are concerned that the tables result in discreet jumps in the outflows when in fact the level of outflow will be more evenly spread.

It should also be noted that if thresholds are always quoted in Euros, this will cause a problem in cases which are very close to the threshold, and where currency conversions could make the difference between being above or below the threshold.

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 are satisfied with the level of detail proposed in the document. However, we are not convinced that higher rates necessarily result in higher outflows in a stress – as evidenced by the fact many depositors left their money with Icesave during 2008.

It will also be necessary to provide details on how often each product will need to reviewed against this criteria (i.e. monthly, annually etc), as a product could change from being rate-driven to not rate-driven in the course of its lifetime.

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

It should be noted that the different methodologies of data collection and analysis undertaken by firms could lead to a variance of characteristic assessment across the industry. Based on this we would recommend opportunity to be given for firms to explain their own idiosyncratic approaches.

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.)?

The paper in its current format asks for data on a reasonably granular level, which will lead to a significant increase the in the resources firms will need to allocate to meet these requirements. This is particularly concerning as the benefits derived to both firms and regulators do not seem to justify the additional spend that firms will need to undertake.

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.

The BBA has no comments.

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

Firms need to be able to apply their own judgments to combinations of factors and the impact they have on potential outflows (see key messages above).

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

We believe the costs will be disproportionately high in relation to the benefits that will be achieved (see key messages above).

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

The formulaic approach advocated in the paper is overly prescriptive and does not provide a tangible benefit to firms.

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

We believe the LCR should demonstrate the minimum outflows and more details should be given under Pillar 2 (see key messages above).

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

The BBA has no comments.