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EBA DISCUSSION PAPER DP 2013/02: RETAIL DEPOSITS SUBJECT TO HIGHER OUTFLOWS

RESPONSE FROM THE BUILDING SOCIETIES ASSOCIATION

INTRODUCTION

The United Kingdom's Building Societies Association (BSA) represents mutual and co-operative banks in the UK, including all 46 UK building societies, with total assets of over £375 billion. As mutual and co-operative lenders, our members, together with their subsidiaries, hold residential mortgages of £245 billion, 20% of the total outstanding in the UK. As mutual and co-operative deposit-takers, our members hold more than £250 billion of retail deposits, accounting for 22% of all such deposits in the UK, and account for 31% of cash ISA balances. Our members employ approximately 50,000 full and part-time staff and operate through approximately 2,000 branches.

The BSA is pleased to make an initial, and high-level, response to the EBA's Discussion Paper. However, in the very short time available, we have not been able to secure much detailed input from our members, consequently our response remains general, and high level. Given more time, we believe that our members, through the BSA, could assist the EBA's thinking on this topic for the following two reasons :

- Building societies have a mandatory focus on retail savings, and are highly experienced on many of the issues covered in the DP ;
- The UK's current domestic regime for liquidity already requires many of our members to categorise their retail deposits as either *more stable* or *less stable*, according to criteria similar to those set out in the DP. This domestic regime has now been in place for nearly three years, so our members are well placed to comment from experience.

The BSA Secretariat would be pleased to facilitate direct contact between our members and the relevant policy staff at the EBA, and will also organize a fuller response to the forthcoming Consultation Paper. For further engagement, EBA staff are invited to contact jeremy.palmer@bsa.org.uk, brian.morris@bsa.org.uk, or andrea.jeffries@bsa.org.uk .

GENERAL COMMENTS

Before answering some of the specific questions posed in the DP, we draw attention to the important issues underlying Article 409(1) regarding transactional accounts and established relationships. Several leading members of the BSA offer full personal banking current accounts that would meet the specification of "transactional accounts" and frequently receive their customers' automated salary credit. All BSA members seek to build established, long-term relationships with their customers, and indeed are successful in doing so. The reasons for this are clear: the fundamental nature of mutual and cooperative banking is to meet the customers' needs, rather than to extract short-term profit from these customers.

Customers of mutual and cooperative banks typically are, or become, members of these institutions, and participate collectively in their democratic governance. For instance, a building society customer with more than £100 in a membership savings account has the right to attend, and/or vote, at any annual or special general meeting of the society: the individual members elect the board and approve, or otherwise, any changes to the society's constitution. During the current season of annual general meetings (March – April 2013) many customers will attend their local society's AGM, and millions more will vote by proxy.

Customers of cooperative banking subsidiaries can exercise membership rights in the parent co-operative. The BSA regards these rights, and their exercise by customer-members, as an important indicator of established relationships. Moreover, independent research[1] on customer service commissioned by the BSA supports the view that mutuals' and cooperatives' focus on their customers results in better customer service and enhanced appreciation and loyalty from the customers.

BSA member institutions have also maintained a strong branch network (as proprietary banks have tended to shrink theirs) alongside newer channels such as internet. These branches are an important focus in their communities, sometimes the only or last savings provider in the locality, and are highly valued by customers, again underlying the established relationship model we describe above. Many high-value depositors, far from being ultra-sophisticated rate-chasers, are in fact older savers who prefer to invest in a passbook-based account at their local society. Branch-based accounts also have operational restrictions on cash withdrawals: typically, there will be a limit to how much cash can be withdrawn across the counter without prior notice, and /or a limit above which withdrawals will be paid out by cheque only.

PROPOSED METHODOLOGY

Experience in the UK broadly supports drawing some distinction between more stable and less stable deposits, correlated with a list of criteria such as those outlined in the DP. At present, many BSA members do the following (in response to domestic regulations):

- They assess the likelihood that the firm's retail deposits will be withdrawn *in response to actual or perceived changes in that firm's creditworthiness* [i.e. idiosyncratic stress];

- They calculate the amount of retail deposits having a *higher than average likelihood of withdrawal in those circumstances* [i.e. less stable]. These less stable deposits attract an outflow percentage twice as large as that applied to the remainder of more stable retail deposits.

Regarding data availability [Q1 refers], the BSA expects that some data will already be available, and indeed be used in the assessments mentioned above, but whether there has yet been sufficient experience over time for this data fully to substantiate or validate clear correlation between the list of criteria and actual outflow rates is doubtful.

STABILITY FACTORS [QQ 2-13]

The list of factors in section 4.2 of the DP includes those currently in use in the UK, but the BSA has identified at least one factor leading to *greater* stability – see below [Q2 , Q12, Q13 refer]. Moreover, we would suggest that there is a degree of overlap between some of the factors [Q7 refers] such that counting them mechanistically risks double counting :

- There will be significant overlap between factors 6 and 7. Non-resident depositors will typically be either sophisticated and/or high net worth individuals.

- There will also be some overlap between factors 1 and 7: almost by definition, high net worth individuals are likely to place high value deposits because they have larger total cash savings.

- There will be significant overlap – for obvious reasons – between factors 4 and 6 : again, almost by definition non-resident depositors will be remote from branches and therefore very likely to rely on remote channels such as internet.

[1] http://www.bsa.org.uk/docs/consumerpdfs/customerservice.pdf - research conducted by independent research agency GfK NOP

- More generally, there will be significant correlation between factor 3, and each of factors 1,2,4 and 7.

The foregoing analysis does not invalidate any of these individual factors, but it must qualify how far observed behaviour can reliably be attributed to individual factors, and given the extent of overlap should **caution against a simple additive methodology** as outlined in the DP – this answers the question posed under Q13.

We suggest that a new factor should recognise the greater stability of savings accounts carrying a tax incentive. The UK experience, with the current tax-free savings vehicle (the Individual Savings Account, or ISA), is that these balances are generally stable – the fact that, although an ISA can be transferred between providers, the tax benefit is lost in respect of any cash actually withdrawn from the account, provides a powerful factor for stability.

Regarding high-value deposits [Q3, Q8 refer], we strongly favour use of the local DGS amount – being outside the Eurozone, anything based on a fixed Euro amount will lead to pointless day to day fluctuation. We do not favour the added complication of an even higher threshold for "very high value" deposits. The experience of our members is relevant here : nearly 80% by volume of our members' retail deposits fall below the UK DGS limit of £85,000, and this volume accounts for the savings of 99% by number of individual customers.

Regarding rate-driven deposits [Q4, Q9 refer], we would reject the concept of "preferential conditions" : deposit rates are set in a highly competitive market in order to attract and retain a desired level of money – and actual rates for different types of deposit account will vary according to the anticipated length of the deposit (under a normal yield curve), the methods and frequency of access, and the size of deposit – all of which affect the cost of administering the account : there is no question of "preference" at all.

We also challenge the idea that "linked products" are a factor leading to lower stability: the DP identifies one limited example of this (which has very little application in the UK anyway): where a deposit must either be placed as a condition of accessing credit, or even maintained as collateral for the loan, and on repayment of the loan, the obligation to maintain the deposit falls away. (This would only be relevant on a random basis, where an individual loan happened to fall due for repayment within the 30 day stress period.)

The BSA considers that there are other, more frequent, instances of linkage where, for reasons of convenience rather than compulsion, the deposit balances are likely to be *more* stable. For instance, a linked current account and savings account, which enables, from time to time, cash either to be shifted to the savings account to earn interest, or to be shifted to the current account to meet higher cheques or payments out, is likely to result in a more stable savings balance. The same is likely to hold for an offset mortgage arrangement, where cash accumulated in a linked savings account may help to offset interest on a mortgage loan. There are also instances where a particularly advantageous savings account is only available to customers who maintain a current account receiving automated salary credit. In all these circumstances, as in the general case of customers having more than one account with the same institution (but without any formal linkage), we would see the arrangements as an indicator of *greater* stability.

Regarding term and notice deposits [Q5 refers], we have already pointed out the likely overlap and correlation with other factors, leading to potential double counting. The BSA also affirms that prudent use of both term and notice deposits actually *reduces* liquidity risk. Customers clearly understand that they are committing their cash for a longer period, or foregoing immediate access, and generally rewarded by a higher rate. What is immensely important are the statements on pages 13 and 14 of the DP that *"clearly only deposits which mature within a 30 days' period according to contractual arrangements need to be considered subject to the outflow factors"* and *"a general classification of term deposits as a* *higher outflow category may lead to unintentional reclassification of such deposits to sight deposits"*. These should be reinforced – whereas the DP narrative under item 3 is vague.

BSA members use both term and notice accounts extensively. With term accounts, it is normal that withdrawals are not permitted during the term. If partial withdrawal is permitted, this can be taken into account in assessing how much of the deposit falls under the 30 day coverage requirement. Notice accounts may typically require 30, 45, 60 or 90 days notice or (in some cases, as an alternative to the full notice) loss of interest for the notice period. Or partial withdrawals may be permitted, subject to conditions. Both these practices can be taken into account in assessing the 30 day coverage requirement. But we do not agree that, in the absence of other factors (and bearing in mind the correlations noted above), term and notice accounts necessarily pose greater liquidity risk. These matters are also relevant to the operational aspects raised by Q10.

Regarding the resource burden [Q11 refers], we expect our members will have certain underlying information about retail flows within their main accounting system – the problem is more likely to be (i) being able to collate and analyse this information so as to answer the questions posed, and (ii) the possibility that individual institutions, even through the crisis, have not had experience of retail outflow stresses (particularly, as in the UK and several other member states, where all bank deposits were for a time protected by a sovereign guarantee at the height of the crisis).

OUTFLOW METRICS [QQ14-18]

We doubt that a mechanistic, additive approach can truly capture the relative levels of liquidity risk in banks' retail deposit portfolios. We have already explained above that the degree of overlap and correlation between several notionally independent factors means an additive approach will overstate the risks of certain types of deposit. We are, overall, not yet convinced that a "Pillar 1" type approach, as embodied in this section of the DP, is any improvement on a more "Pillar 2" –type approach, whereby the institution would make an assessment (having regard to an indicative list of criteria) which of its deposit balances are more or less stable, taking account of contractual terms and documented experience, and this assessment is then reviewed and if necessary challenged by the national supervisor.

CONCLUSION

The BSA supports the principle that not all retail deposits are equally stable, and that the inherent differences in outflow propensity between product types should be recognised in liquidity coverage. But we do not support a mechanistic, additive methodology as outlined in the DP, which we consider suffers from notable theoretical and practical flaws.

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