European Banking Federation

Brussels, 1 October 2013

Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of some 4,500 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU alone.

EBF Draft Response to EBA Consultation on draft Guidelines on retail deposits subject to different outflows for purposes of liquidity reporting (EBA/CP/2013/34)

The EBF welcomes the opportunity to comment on the EBA consultation paper related to the draft Guidelines on retail deposits subject to different outflows for purposes of liquidity reporting. We do, however, have some concerns related to the proposed methods, which are described in detail below.

General Remarks

Suggested Method to Allocate Higher Outflows

The method that is suggested to allocate higher outflows is odd in that it is a very prescriptive *one-size-fits-all* classification process (risk factors to consider *and* mapping to three categories) and banks have to allocate runoff factors for each of these hard-wired categories. As a number of the risk factors are not available to banks, even more so on historical data, judgement will need to be applied to determine the application of these runoff factors.

Overall, it would make far more sense to allow banks to determine their own methodology to derive categories of higher outflows that they will allocate. The risk factors in the consultation paper could be suggested as risk factors to consider in the internal model approach.

Therefore, we recommend that EBA:

- leaves more categories open to set different outflow rates;
- that the distinction between high risk and very high risk factors is given up, as institutions might not find in their internal data the same ranking of risk between retail deposits as prescribed by EBA;
- more generally, that the combination of criteria does not lead to a pre-defined order of riskiness, as institutions will not necessarily find in their historical data the same order.

Level playing field and impact on the economy

So far as we know, no other jurisdiction in the world has made the Basel III proposal super-equivalent by allocating higher outflows on retail deposits in the LCR. This will put European banks, and the European economy at competitive disadvantage vis-à-vis other jurisdictions. The consultation paper is silent on estimating the impact on European banks' LCRs, and on factoring in the suggested method in the ongoing work EBA is tasked with to determine the impact on the economy.

We urge EBA to run Quantitative Impact Studies (QIS) before setting in stone the proposals to better understand and foresee the consequences.

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Scope of Application

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. **It is not consistent that retail deposits that have already been defined as "stable deposits" by the Capital Requirement Regulation (CRR) will be subject to an additional set of risk factors.**

Furthermore, retail deposits covered by a Deposit Guarantee Scheme but without established relationship or transactional characteristics should be considered less stable but with an outflow rate that should not exceed the Basel III 10% rate. **Assigning higher outflows would mean not to take at all in consideration the benefit coming from the application of the Guarantee Scheme**.

For example, in case of deposits that exceed EUR 100.000, the portion below 100.000 should be assigned a 5% or 10% run off factor (5% if in presence of an established relationship or transactional account), and only the portion above EUR 100.000 should be considered for potential higher outflows.

We also note that the criteria for higher outflows for retail deposits affect purely the LCR and should not trigger changes to the NSFR factors.

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

The use of internet based distribution channels has increased substantially. This makes the assumption that this channel leads to higher outflow rates questionable. The popularity of digital channels is such that almost all banks see this as a key area where they can better serve their clients' needs, by offering them time and location independent services. Many banks have stated they will be focusing on enhancing the web based services in the years to come. This is also underlined by the popularity of mobile banking on smartphones and tablets. Mobile banking is already the primary source of client contact for a number of banks that used to be primarily 'bricks and mortar' banks.

Furthermore, customers that have an internet access to their banking account are not only those ones that have opened a deposit online; in fact, also those deposit retailers that initially set up a new contract directly at branches, may additionally require to open an online access for the same banking account.

Also, for internet deposits, there is a difference between internet only savings accounts and the ones where the internet is one of a number of distribution channels. Client behaviour might also differ per country.

With regard to the possibility to react remotely and instantaneously to market movements, it is true that through internet the risk is higher in terms of time, but however also for customers that have no access to their accounts online, they may close deposits or transfer their cash balances in a short time horizon (hours).The decision to transfer the available cash is independent from the fact that the client has online access to its account. For these reasons, there is not a great difference if a depositor has also internet access, taking into account that the LCR is computed on a 30 day horizon. If this risk factor will be maintained, banks will have no incentives to use and promote this type of deposit, with the consequence that they may stop to offer these online accounts.

Against this backdrop, the availability of internet as a channel to interact with the customer should in itself not result in higher outflows. Additional drivers for higher outflows should exist.

In addition, the treatment proposed for brokered accounts should be applicable only to funds which are collected by brokers, booked in the sole name of the broker and fully under the discretionary control of the broker. Other accounts which may be collected through the broker channel but which do not have these characteristics and where the natural person can be identified should be treated as a natural person.

Internal model

It is not clear why or how internal models could be applied in a prescriptive framework. Internal models could be used to define internal percentages, but we do not agree with the prescriptive use of internal model to define other characteristics. The use of internal models takes away from the stated aim of the CRR: "The level of liquidity needs in a short term liquidity stress should be determined in a standardised manner so as to ensure a uniform soundness standard and a level playing field (See Art 101)."

As for the market, credit and operational risk framework, **internal models should be adopted by the most sophisticated banks as an "alternative" to the standard approach and not "in combination with" the standard approach**. IT investment will be already exorbitant for the implementation of the standard framework taking in consideration the huge amount of data (millions of retail depositors). Furthermore, results may be inconsistent across banks given different operating models which again weakens the objective of standardisation and comparability.

On the other hand, it would not be useful to store the deposits of individual depositors as the stability of retail deposits derives from the presence of myriads of depositors which act in a different manner but that, on average, maintain a constant amount of total deposits. Reasoning on behalf of each depositor and on the volatility of the individual depositor while being costly, could also lead to an overestimation of the phenomenon even in times of crisis. As currently stands applying all the outflow factors would apply worst case experiences from some individual deposits to the entire deposit base.

Some of our members have access to historical data on retail deposits for a combination of systemic and idiosyncratic crisis (in Sept.'08) and experienced a lower than 10% actual runoff factor. We note that in the case of the Belgian bank Fortis during the 2008/2009 financial crisis while there were high levels of outflows for some individual deposits, only a 7% outflow of total deposit was experienced in the case of the whole deposit book. If some portions of retail deposits are allocated a higher outflow rate, some other portions of retail deposits should be allocated a lower outflow rate to remain consistent with actual experience.

In addition it should be noted that a number of variables could change future outflows including the interest rate environment (where deposit rates may be temporarily increased through margin compression to manage retentions over those of low rate periods).

Term deposits

We do not agree with the fact that term deposits should be penalised by higher outflow rates being in some cases a form of optimal short term liquidity. If the term deposit is connected to a bank account, it should maintain the same characteristic of the bank account.

While EBF Members would be reluctant to classify the term deposit as a "transactional" account itself the existence of a transactional account held by the customer could be a quite strong indicator for an "established relationship." Therefore, we would argue that if the term deposit is connected to a bank account, which is classified as a transactional account or as an account with established relationship, the term deposit can be classified as "account with established relationship." The higher outflow should only be applied where there is no historic evidence of material retention levels from rollovers/cross product sales.

Finally, it is not clear what the treatment of retail bonds is. We believe they should not fall under the definition of term deposits.

Lower outflows rates

Page 5-6 *".... Therefore, while Article 421 (1) and (2) concerns minimum outflows rates, Article 421 (3) relates exclusively to higher outflows"*

The Article 421 (3) relates to the identification of retail deposits "subject to different outflows" and so not just exclusively to the higher outflows category. While we agree with EBA' statement in the cost-benefit section (page 18), that EBA is to consider a new category of lower outflow rates (i.e. the 3 % runoff rate introduced by the Basel Committee in January 2013) in accordance with Article 509 (2)), we believe that it is within EBA's mandate ("different outflows") to consider this already in these Guidelines. **If institutions need to make IT investment in a very short time, it would be worthwhile that the entire framework is defined as soon as possible.**

Determination of established relationship, transactional account and the risk factors approach

Institutions should have available historical data: a suitable time series (i.e. 2 years) will be available only in the future, restoring old data could be very time consuming and costly for IT implementation.

Established relationship criteria (a) "has an active contractual relationship with the institution of a minimum duration": the two items (active relationship and minimum duration) should be split into two different criteria in order to avoid computing burdens. A clear definition of minimum duration would be helpful (is it the customer relationship from its first product holding?)

It should be pointed out that the set-up and maintenance of all risk factors proposed by the CP may generate cumbersome administrative efforts and excessive costs for banks in terms of IT architecture complexity (also in light of monthly LCR calculations and T+15 remittance date). Some of them, like the need to perform peer analysis on a monthly basis on interest-rate driven contracts seem not to be manageable, also in light of the T+15 LCR remittance date.

Adoption of behavioural internal validated models could be more realistic and cost-effective as an alternative to (not in combination with) the prescriptive/standardised risk factor approach.

Product-linked deposit

This characteristic could be important to determine run-off percentages for corporate customers, not for retail ones. If a mortgage or other long term loan comes to maturity, it is unlikely that the retail depositor leaves the bank after a relationship that has lasted for years. The definition could be limited to personal loans or short term loans that come due. Similarly linked/security backed deposits may be retained after the loan repayment from other external cash sources.

Proportionality and Materiality

Although we recognise that the assessment process completed by banks to identify retail deposits subject to higher outflows must be documented and based on models comprised from past behaviour of depositors and hypothetical stress scenarios, it should be proportionate to the bank's portfolio of retail deposits relative to the total assets.

At some point, the amount of time and resources put into the process of identifying other characteristics that might indicate a retail deposit type with higher outflow rates will be disproportionate to the marginal change in total cash outflows after such an assessment.

In general, it also seems disproportionate that institutions shall document non-existence of other characteristics since this essentially will be a non-exhaustive list of characteristics not expected to be significant to be examined.

We also note that some sub-categories might be so small for institutions that the volatility of deposits that is calculated is not representative. There should be a materiality threshold under which it is not necessary to treat differently the retail deposits (for example under EUR 50m, it is not necessary to treat the sub-category differently compared to the other categories, as statistical data may not be representative).

Basis of Proposal

The consultation paper refers several times to a 'survey of competent supervisors' as the basis for its proposal. For sake of transparency, it would be helpful if the EBA could publish the material considered by the EBA. This would enable respondents to the consultation to better understand the rational and justifications underlying the EBA's final guidelines.

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Related documents: http://www.eba.europa.eu/documents/10180/205409/Draft-CP-on-RTS-on-additional-collateral-outflows---final-to-be-published.pdf

Response to Consultation Questions:

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?

Yes, though the definitions are not precise enough:

- part(a) minimum duration of a relationship and the meaning of "active" should be formally defined. If active means a minimum number of operations in a given period of time, it would be better to split "active relationship" and "minimum duration" into two different criteria
- part (b)should just refer to 'other loans' as opposed to 'other long-term loans'. We believe that deposits that are pledged as collateral to the financial institutions should also be added as well as personal loans to retail.
- In the criterion c) it is not clear what the amount of minimum number of active products is. EBF Members argue that the existence of an additional product is sufficient for identifying client's stability. The term "active" could be replaced by "commercial", including for examples current accounts, asset management products, insurance products, saving/accumulation plans, presence of a security account , presence of credit lines granted to the customer.

Furthermore, established relationship could also refer to other important criterion such as:

- employees' deposits,
- retired employees' deposits,
- members' deposits, such as members of co-operative banking companies,
- the age of the account meaning the duration of the customer relationship.

Those criteria could be applied when this type of relationship is proven to make withdrawal highly unlikely. A clearer definition of what determines the relationship will avoid inconsistencies across the industry. It should be possible for banks to use other criteria to validate an "established relationship" if they can demonstrate to the satisfaction of their supervisor that these criteria are robust.

In light of the fact, the regulator is explicitly mentioning need for Banks to have available historical data on the behaviour of depositors, to substantiate the classification of the depositors, we deem that the data retrieved by underlying validated econometric behavioural models, may represent a better evidence of client relationship stability (intrinsically considering all possible underlying factors) rather than the effort to try to identify and manage a specific list of risk factors.

Q.2 Do you agree with this criterion for identifying a transactional account?

The EBA definition is not fully aligned with CRR 421 (1 -b) where it seems that the crediting of salaries represents a sufficient but not necessary condition (as there could be other transactions that may be considered), in order to consider the account as transactional, whereas the EBA CP stated that a transactional accounts is when salaries and transactions are regularly credited.

We suggest reformulating it in the following way "…salaries or transactions…" The reason is a client might use account for regular expenses even without regular salary payments. In addition salaries are difficult to identify, especially for freelancers. We believe "transactional account" should be based not only on salaries regularly credited but on regular payment transfers (including SEPA Direct Debit).

Further, we believe that only having one transactional account (i.e. the one where salaries are credited) is not up to speed with the current developments in the retail banking market today. Clients do have more than one transactional account.

It is not clear if the EBA's definition for transactional account is consistent with the definition of "payment account" in Directive on Payment Services (PSD). It would be reasonable to have uniform definitions throughout the regulation.

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?

Minimum duration should be used to assess contractual relationship.

With regard to the definition of "active" in the sense of being actively managed, it should be demonstrated that "active management" of a product has a direct relation in terms of stability on the relationship with customers. In fact, products are managed and used considering the effective needs of each client.

The control of the number of products that are active for the customers is something that is part of the commercial activity in the sense that it is an indicator of the commitment between the institution and the depositor. Furthermore, it should be pointed out that each product type may be characterised by a peculiar attribute "active management," that may represent an intrinsic characteristic of the product (it may be normal that a product is not accessed with high frequency).

Considering the complexity of the topic, we do not support the introduction of the "active management" attribute.

The term "active" could be replaced by "commercial", including current accounts, asset management products, insurance products, saving/accumulation plans, presence of a security account etc.

With regard to the definition of "minimum number", we recommend that the minimum number of active products could be two products to include retail products e.g. loans, deposits, current accounts, etc.

Furthermore, only having one active product is not a risk factor per se. A long time customer's deposit – even with only one product – can be very stable.

Alternatively an active contractual relationship account could be defined if the account would have at least one transaction during the preceding month or where the customer has at least one product that is for daily use (e.g. credit card, chance to manage accounts online).

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

There's no empiric evidence about different behavioral approaches among different threshold proposed. It seems that more attention is given to the value on retail deposits and not on depositors. We don't believe high and very high values are a good proxy currently and the thresholds should be higher. Further, the thresholds should be combined to avoid a cliff effect and reduce the complexity of the calculation. For example, the values do not allow for joint accounts which may lead to more very high value deposits. The amount of the deposit cannot be the only criteria to prevail. If the deposit is pledged as collateral the depositor does not have the possibility to take it away, so these deposits are quite stable.

Also, we believe that all amounts up to the prevailing DGS insurance coverage level should be excluded from having any higher risk factors applied (for joint accounts the insured amount will have to be doubled). We propose to only distinguish between deposits covered and not covered by the deposits guarantee scheme. If EBA does not follow this reasoning, the risk factor should only apply to the amount of the deposit above the limits established by EBA (see also our general comments).

Attaching the threshold to the DGS amount is not consistent because the higher 10% outflow factor is already applied to those deposits that exceed the DGS amount. If the idea is to identify deposits that are subject to higher outflows than 5% or 10%, then the threshold value should be higher accordingly.

It is suggested that if the total amount of client's deposits is higher than 100 000 EUR or 500 000 EUR, the total amount of that client's deposits is considered high or very high value deposits, respectively. The methodology should take into account only the amount exceeding the threshold limit because the "semi-professional" retail client may have a very active established relationship with the bank (for example a deposit account that is used for paying mortgage payments every month) so a portion of deposits is in fact very stable.

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

In theory, deposits are rate driven, but in practice in countries where the cost of funding is high, the level of deposit rates is also high, and surely much higher than in countries in Central or Northern Europe. In certain moments the level of deposit rates was so high that central banks had to create a penalty for deposits with rates over a certain limit. In these countries, these deposits are the ones that are really rate driven.

We also question the presumption that high yield deposits are volatile in times of stress. On the contrary, high yield deposits could actually be one of the most stable investments in times of stress. If the stock market falls in market-wide stress, the depositors might actually keep their investments in bank accounts if the return would be high.

Even if a deposit was initially "rate driven", this motivation is typically no more valid for the reinvestment. The potentially "rate driven" motivation of term deposits which have been raised some years ago is outrun by the current situation with changed customer needs (asset structure, liquidity preferences, personal situation etc), general market conditions and the current bank strategy. Furthermore, it seems quite impossible to collect sufficient market data deposits across the whole interest rate curve. Therefore it should be made clear, that the criteria "rate driven" applies for sight deposits and call money with notice period <= 30 days only.

However, we don't think this criterion will work in a small market because there will be a limited number of peers to measure against. Index based products may not exhibit any different behaviour than a low rate account given there may be no promised return at maturity and certain products offer tax exempt status.

Furthermore, even in a market with enough "peers" it would be difficult to identify these peers and to monitor all their products and rates. We believe it would be fit for purpose if banks could decide on their own when a product is rate driven, because a bank knows its own funding costs best.

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

We don't agree entirely with this criterion. The rationale underlying the need to open a deposit abroad may derive from an effective need. The recent historical experience proves that the deposits of non - residents with origin in the jurisdiction in question are quite stable, independently of the currency of the deposit. The criteria should be overridden where the relationship with the customer is of a material duration.

The residence of the retail depositor is not an essential factor when assessing the stability of deposits. For example, the salary might be paid into a domestic bank's account for a non-EU resident who is working abroad for a domestic company. This does not imply that the deposit is less stable.

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

Yes though no acknowledgement that the riskiest deposits have been stripped out of the remainder of the retail deposits bucket.

The new treatment concerning deposits may have a significant impact on the dimension of liquidity buffer. The pricing of the deposits and also the characteristics of these may have some changes. Without an adjustment for treatment for joint accounts, it may result in a high level of change in the industry to cease offering same.

In addition, we suggest to consider as a cost the operative impact (staff, resources, IT) of reconciling and reviewing internal models (deposits stability) already developed for interest rate risk purposes with the Basel III analyses on deposits stability for liquidity purposes.

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

In what concerns IT, the level of information must be much more detailed than it is now in order to identify the deposits that require bigger outflow rates. This requires significant IT costs, while the data required to identify different buckets have not been thoroughly evaluated yet. The number of permutations that are possible from the multiple criteria also increases the inability to perform regression analysis. A single customer view may be available to all industry members on a regression basis.

We would consider that the assumptions concerning the identification of different retail outflow rates requires further analysis to ensure that the IT implications are in line with the flows which may have been observed during the crisis.

We strongly believe that on such topic a calibration phase should start now until 100% minimum requirement is introduced, in order to assure level playing field and unintended consequences for the real economy.