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EACB Comment Letter to EBA on draft Guidelines on retail deposits subject to different outflows for purposes of liquidity reporting (EBA/CP/2013/34)

Ladies, Gentlemen,

The European Association of Co-operative Banks (EACB) welcomes the opportunity to comment on draft Guidelines (GL) setting out the criteria to determine the conditions of application of paragraphs 1 and 2 of Article 421 CRR in relation to the identification of retail deposits subject to different outflows and the definitions of those products for purposes of liquidity reporting (EBA/CP/2013/34).

All in all, we believe that, given the costs and the complexity of the methodology, the draft GL requires important modifications, in the direction of a simpler approach encompassing fewer risk factors.

Please find our remarks and responses to selected questions in the following pages.

We will remain at your disposal,

Yours sincerely,

The EACB Secretariat

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A. GENERAL REMARKS

The criteria and the risk factors proposed in the draft GL will have an important influence on the size of the liquidity buffers to be maintained (the numerator of the LCR) and the consequent balance sheet opportunity cost so that these guidelines are of high importance. Unfortunately, we are not aware of any studies which would provide an empirical evidence on the EU level, identifying which kind of retail deposits, during the crisis, have shown high volatility and which kind of factors had an influence on them. Moreover, it is not yet clear, to what extent retail deposits may or may not be affected by the bail-in. Without these information it is very difficult to define risk factors for retail deposit subject to higher outflows that could coincide with the specific experience of the market participants. The behaviour of retail depositors is 'market specific' and the 'free movement' of retail deposits within the EU is an unrealistic assumption for a high percentage of retail deposits.

We are afraid that the risk factors suggested in the draft GL do not provide for sufficient criteria to differentiate between deposits within the paragraph 1 or 2 of Article 421 of CRR. In particular the indicators suggested with regard to the existence of an established business relationship (Art. 421(1)(a)), and to deposits characterized by a typical retail operational activity (Art. 421(1)(b)) should be reconsidered. Deposits characterised in such a way, asunder Art 421(1)(a),(b), naturally tend to be more stable; however, the suggested factors affecting the stability of retail deposit products (Part 2) may also impact these stable deposits, and unduly shift them to higher outflow categories. It should be made clear that those risk factors shall not be taken into consideration for deposits already falling into the scope of Art. 421(1)(a) and (b).

We appreciate that EBA excluded from the risk factors the high net worth individuals, that had instead been listed in the Discussion Paper. Nevertheless, we still feel that the proposed methodology is too complex, and risk factors are not independent from each other. Moreover, the aggregation rules indicate implicitly, that among the high risk factor the 'other risk' factor may only play in the direction of increasing the outflow rate, but not decreasing it. We think that the methodology should be further simplified.

Since the Consultation is carried on draft Guidelines and not on ITS or RTS, it is not quite clear who would be in the position to 'comply or explain'. It is of great importance to know whether reporting institutions can deviate from the guidelines and report the specific items in more favourable buckets than those suggested, when they provide well supported reasons. It would also be useful to know whether deviation from the guidelines in more favourable direction can be authorized by national authorities.

Data collection and assessment

The collection and the assessment of the relevant data, requested in the draft GL, will constitute an onerous task for the institutions, especially on a group-wide level. The diversity of systems is a key issue, along with customer-wide precise information, that is not always readily available for each bank of a network. In addition the proposed categorization is overly complex, therefore implementation in IT systems will result difficult and costly. Depending on the systems the application of the proposed scorecard methodology would require the development of a separate IT support.

The complexity of the methodology will also impact on the time constraints under which the banks will have to operate. There are less than six months between the application date of the CRD-CRR (and subsequently of the guidelines) and the submission date of the first supervisory reports, to develop and test the IT systems.

In our view a longer implementation period should be granted, our suggestion would be to allow banks to have at least a 12 months period to develop, test and launch the required IT supports.

Significant resources will already be deployed by banks to prepare the IT systems for the EBA observation period, additional resources will nevertheless be required to assess the proposed criteria, raising the implementation costs of the draft GL.

Additionally, the remittance delay for liquidity data is 15 calendar days. Such a short delay makes it very challenging to report on the liquid assets, the net outflows and the other treatments for liquidity requirements purposes.

In the light of the other information requirements to be submitted (liquid monitoring metrics, liquid assets categorisation, additional collateral outflows), the EBA may provide an indication of the priorities, to support institutions that would not be able to meet all the deadlines.

B. SPECIFIC REMARKS

Maturing fixed-term or notice period deposits

We do not consider that fixed term or notice period deposits shall be included in the "very high risk" category, for the determination of higher outflows (Part 3, 14.2(b)(i)). The choice between sight and term deposits is, in fact, often dependent on the interest rate term structure, which by itself, does not imply a higher outflow risk. Such risk, as we will see for rate-driven products (See Q.5), rather depends on whether the perceived creditworthiness of the institution, which is also linked to whether or not the institution is a Systemically Important Financial Institution (SIFI). We also find hard to understand the rationale between the distinction of "internet only access deposits" as high risk, and "maturing fixed-term or notice period deposits" as very high risk.

Proportionality

Given the costs and the complexity of implementing the proposed methodology, there might be the case of banks not being able to fully apply the guidelines. For that reason, we suggest that such banks, especially the smaller ones, should be allowed to classify all relevant deposits within the third bucket described in the draft GL (Part 3, 14.4). Therefore an appropriate minimum outflow rate for that bucket could be applied to all the deposits there included, such rate may be provided by the EBA or left to national discretion. Indeed, especially in the case of small institutions, the costs of the methodology proposed are likely to outweigh the benefits.

This being said we also would like to point out that higher risk factors should in any case not be considered for deposits:

- placed by a co-operative bank within its own members, setting aside very high value deposits which represent a significant part of the retail deposit base; or
- covered by a significant amount of their nominal value by the DGS and a co-operative banks' mutual solidarity system.

Moreover it has to be taken into account that in the case of small co-operative banks some of the risk factor identified by the Draft GL cannot be regarded as factors affecting the stability of retail deposit products. For instance, membership in a cooperative bank is generally remunerate through the pricing of deposits and loans. Thus comparing the rate that co-operative applies to each deposit placed with its members to the average paid by their peers for similar products would not be appropriate. On the other hand, identifying a suitable average rate of peers could be really difficult to obtain since there might not exist other co-operative banks in the markets in which the former operates.

C. ANSWERS TO SPECIFIC QUESTIONS

Question 1:
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?

The criteria for determining stable deposits on the basis of established relationship (a) and (c) (Part 1, 3) should exclude the qualifier "active". We think that, if a certain client relationship, or product (as outlined in the draft GL Part 1, 3(a), (c)) is defined as "active" on the basis of the frequency of contact and handling, such interpretation may be misleading as to the main driver of the stability of the relationship. The lack of such frequency of contact, in fact, may well be related to a greater stability of the deposits and an associated lower outflow rate.

Furthermore, in our view the definitions are not quite precise. Concerning criterion (a) related to active contractual relationship with a minimum duration, we see that there is no clearance on what is the definition for minimum duration. Moreover, if any such criteria will persist, we would prefer the term 'length of period', as the term 'duration' is often associated with the calculation based on the concrete formula. In the criterion (c) on the other hand, there is no definition of the amount of minimum number of active products. We think that the minimum number of active products may be an inappropriate indicator of a well-established relationship as it is highly dependent in what organisation structure the client is serviced. For example, in co-operative networks leasing and factoring products are generally offered to customers by a specific financial institutions, in such case the member banks only transmit these products to their clients, *de facto* having no relationship with the customer. It would be also useful to know whether these are to be updated by EBA after receiving answers for question Q3.

The proposed definition of an 'established relationship' may also be understood as a situation where the customer's deposit is connected in some way or another with 'active banking operations'. ('Active banking operations' in this meaning, are operations related to the banks' asset side, in contrast to 'passive banking operations', which are operations on the banks' liability side.) We think that apart from jurisdictions where loans and deposits to one customer can be netted (on-balance-sheet netting), active banking operations with a customer are not necessarily a proof of stability for the deposits, which are passive operations. In our view the range of services contracted between the bank and the customer or the length of the relationship from the signing of the first contract between the customer and the bank, are more characteristic to a well-established relationship. Another case may be when the relationship with the customer relates to a specific products/services which are not offered by many participants in the market and which relationship is connected in some way to a deposit account. In this case, the stability of the relationship is stemming from the specific products/services.

Established relationship could also refer to any other important criterion: the age of the account meaning the length of time of the customer relationship, or other client specific factors concerning customer relationship that would increase the stability of deposits.

On the other hand, as the required reporting is for the purposes of determining liquidity ratios, criterion (b) must take into account the relevant time horizon for the position subject to reporting for what concerns the term of the loans. For example, short term loans shall not be excluded from the outset, when their residual maturity lies within the reference timeframe to be reported. The existence of loan contracts, regardless of their contractual maturity (long-medium-short term), would therefore be sufficient criterion for consideration of a stable relationship, provided that in one way or another they are related with deposits, too (examples may include, but not be limited to: revolving facilities, loans to be covered by pledged deposits, etc).

Due to the above mentioned we propose to further develop the definition of the well-established relationship.

Question 2:
Do you agree with this criterion for identifying a transactional account?

The definition of transactional accounts in Part 1(4), seems to refer to an account used for both deposits and current payment account with many entries (e. g. salaries). This would be an unusual configuration, as, normally, different accounts are used for deposits and for current account items. It could be clarified whether the draft GL also include, for example, deposits of clients without an approved overdraft limit in their current account. For such accounts, in fact, in order to ensure a normal liquidity management clients usually hold some funds therefore being in a 'depositor' position on their current account. Apart from the above mentioned case, if the conditions specified in the draft GL, to qualify the account as transactional, are to be met jointly, this would leave out a number of accounts that are actually used for regular retail transaction purposes.

It is unclear whether or not the EBA's definition for transactional account is consistent with the definition of "payment account" in Directive on Payment Services (PSD)? It would be sensible to have uniform definitions throughout the legislative acts and the guidelines.

We think that such definition should therefore be clarified to allow a better understanding. In the text salaries are mentioned as a regular credit item, but in our view when transactions are frequently credited and debited should be also treated as transactional accounts. An employee's salary or a pensioner's pension are regular items, but for a self-employed person the items are not necessarily regular, but may be only frequent. The same is true about debit items, they must not be necessarily regular, moreover, if credit items are acceptable then debit items can be not only irregular, but also less frequent. The examples mentioned refer to current accounts. However, depending on the IT support, apart from current accounts, there may be other type of transactional accounts e.g. for securities transactions. In our view, these accounts also should be treated as transactional accounts. Therefore we suggest the following wording: "*Transactional accounts are customer accounts where salaries, pensions and other transactions are regularly or frequently are credited for the customer and various transaction as money withdrawal and transfer or other transactions are debited from time to time.*"

Question 3:
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?

We think that, if a certain client relationship, or product (as outlined in the draft GL Part 1, 3(a), (c)) is defined as "active" on the basis of the frequency of contact and handling, such interpretation may be misleading as to the main driver of the stability of the relationship. The lack of such frequency of contact, in fact, may well be related to a greater stability of the deposits and an associated lower outflow rate.

It has to be mentioned too, that in general actively managed means the number of transactions related to an account. Depending on the IT support not all banks monitor the active management of the customers' accounts, rather from time to time they check the so-called 'sleeping accounts', where the customers seems to have forgotten about their accounts with the bank. The balance of these 'sleeping accounts' remain rather stable even in times of stress.

Question 4:
What is your view concerning the threshold proposed for high and very high value deposits?

We see two kinds of issues if the value of a clients' deposits is calculated as the sum of the customer deposits with the institution (Part 2, 6.3):

i. the threshold amounts to classify a deposit as high value, or very high value (and therefore account for the relative risk factor) would be reached more easily, inflating the total amount of high or very high value deposits.

ii. once accounted for the part covered by a DGS, that should be by definition less volatile, it would not be possible to distinguish, for deposits of the same client, the ones with characteristics that could make them less prone to volatility (and, hence, due to the absence of other specific risk factors, not subject to higher outflow rates).

In our view, indeed, the threshold for the high value deposits is too low. Attaching the threshold to the DGS amount would not be consistent because the higher 10% outflow factor is already applied to those deposits that exceed the DGS amount. If EBA intends to identify deposits that are subject to outflows higher than 5% or 10%, then the threshold value should be higher accordingly.

In the draft RTS it is suggested that if the total amount of client's deposits is higher than EUR 100,000 or 500,000, the total amount of that client's deposits is considered high or very high value deposits, respectively. We believe that the methodology should take into account only the amount exceeding the respective threshold limits for high value and very high value deposits, consequently applying the most appropriate outflow rate to each portion of the same deposit. In fact, a "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), therefore a portion of the deposits would be indeed very stable.

One further issue is represented by the nature of structured deposits: such deposits can be indeed classified among retail deposits, but given their specificity of combining a deposit with an investment product (a financial asset, a benchmark etc) cannot be subject to a DGS. In order to obtain a customer based aggregation of deposits this will lead to relevant issues in the IT systems, as these data are not readily available and a new IT structure would need to be implemented.

Finally, taking into account that the thresholds for retail deposits is EUR 1 million and that for the insured deposits is EUR 100,000, if high-value deposits are to be defined on the European level, independently from the wealth level in the different Member States, the EUR 500,000 limit seems reasonable. Nevertheless, we would like to underline, that the limits should take into account also the bail-in categorisation.

Question 5:
Do you agree with the criterion for considering a deposit to be rate driven?

The criteria set out under (b) and (c) are mostly characteristic to structured deposits, where the higher volatility, i.e. the higher risk of the return is compensated by higher return in general. They do not necessarily foreshadow higher relative volatility of deposits. Rather, they may reflect saving and investment strategies of the customer, including portfolio diversification, that, enhancing the overall risk position of the client, result in greater stability. Moreover, the typical contractual terms underlying deposits with such features, often reduce further mobilization capacity: penalties are, in fact, usually applied. The classification of a deposit as rate driven should therefore be based solely on the criterion set out under (a): a deposit that, compared to the relative deposit market and competitors' offers, significantly exceeds the average of similar retail products.

Nevertheless, such a definition would leave room for some practical difficulties. Average rate of peers could be really difficult to obtain since banks do not have an obligation to disclose deposit rates or offers. In addition, the definition of "peers" itself could present some issues as there might not exist institutions with a similar business model and size.

Furthermore, high rates cannot be regarded as a risk factor by themselves: relating such factor to an issue of creditworthiness might be more revealing. On the one hand, less creditworthy institutions often offer products with higher rates, thus attempting to attract funding that would otherwise be channelled to more solid institutions. On the other hand, this does not imply that high rates are the prime cause of higher outflows, high rates can be offered also by banks of good credit standing, for example for commercial purposes.

In our opinion, a general statement that high yield deposits are volatile in times of stress or in some cases less stable, could be questionable. If the stock market falls in market-wide stress, the depositors might actually keep their investments in bank accounts if the returns would be high.

We think, indeed, that the perceived creditworthiness of the institution, acts as the decisive factor leading depositors to withdraw their funds under a stress scenario.

Nevertheless, if EBA is to maintain criteria b) and c) and disregard the credit standing of the specific institutions, then, in our view, only those deposits should deserve higher outflow rate where there is no material penalty in case of deposit withdrawal before the maturity date.

Question 6:
Do you agree with the criteria to identify this risk factor?

We believe that the residence of the retail depositor is not an essential factor when assessing the stability of deposits. For example, the salary might be paid for 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.

As for the deposits of non-resident migrants, the suggested criteria are not in line with the practical experience of members: those deposits show a highly stable behaviour. One reason is that these funds are held, on a precautionary basis, to finance extraordinary expenses or investments that emigrants may incur in the jurisdiction where they settled. On the other hand, the fact that migrants reside outside the EU shall not be accounted as a risk factor itself, safe, eventually, for the very effect of a deposit currency other than the one currently exchanged in the country where the deposit is open. This risk is nevertheless already factored in another risk factor proposed by the EBA, i.e. the currency of deposits. Furthermore, it should be emphasized that in several European countries with significant emigration flows, the deposit portfolio of emigrants has a greater impact in the portfolio of retail deposits of credit institutions. The weight of emigrants' deposits on the deposit portfolio of their home country has grown more relevant under the current economic scenario.

Therefore, emigrant deposits (non-resident), including those of customers established outside the EU, should not be discriminated in relation to resident deposits, and hence should be excluded from this risk factor.

A threshold might be defined for non-residents' deposits to be considered as subject to higher volatility, such threshold should be defined set to EUR 500,000.

Question 7:
Do you agree with the above analysis of the cost and benefit impact of the proposals?

The proposed categorization seems too complex, and therefore difficult and costly to be implemented in IT systems. The costs of collecting and assessing such information might outweigh the benefits, especially for smaller institutions.

The application of the risk factors outlined in the draft GL will impact the liquidity buffers to maintain. As a matter of fact, by inducing an extended liquidity cushion, excessive outflow rates will reduce banks' return on assets, as a consequence of the cost-opportunity of keeping liquidity that could be channelled in more remunerative investments. This may lead banks, in order to achieve higher profitability, to increase funding costs for corporate and private customers. Credit shrinking, or increased costs for retail customers, may have a depressive impact on the development prospects of the real economy. This represents a crucial issue for credit institutions, such as co-operative banks, that base their business model on the collection of funding through the retail deposit market, and on the support via credit to the economy of local communities.

While the cost are high, 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 favour a simpler approach with only a few relevant factors (high value deposits and rate driven deposits). We think that the methodology should be simplified (fewer factors included) and the distinction of the two risk categories of risk factors deleted, as it seems unnecessary.

Question 8:
Please provide any evidence or data that would further inform the analysis of the likely cost-benefit impact of the proposals.

In our view, it has to be taken into account that any kind of information on retail deposits which goes beyond the information that has to be provided to the national deposit guarantee schemes concerned will involve material IT costs, especially on a group or network level. By now, the deposit guarantee systems in general refer to legal entity level and not to the group level. In the CRR the definition of retail deposits are the same for the specific legal entities and for the groups. Before the CRR, there has been no need to aggregate the deposit information on a group/network level. The aggregation task will already be difficult for a number of institutions, and the EUR 1 million limit for retail deposits on a group / network level may be exceeded. Moreover, in some cases the transfer of information on individual deposits could be problematic because of the national bank secrecy rules. Guidelines should ensure that depending on the application of the relevant DGS, insured deposits should get a favourable treatment independently from the aggregate sum of the deposits concerned on a group/network level.