



MONITORING OF LIQUIDITY COVERAGE RATIO IMPLEMENTATION IN THE EU — FIRST REPORT

12 July 2019

EBA

EUROPEAN
BANKING
AUTHORITY

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Abbreviations

ABS	asset-backed securities
ALMM	additional liquidity monitoring metrics
COREP	common reporting
CRR	Capital Requirements Regulation
DGS	deposit guarantee scheme
EBA	European Banking Authority
EU	European Union
HQLA	high-quality liquid assets
ITS	Implementing Technical Standards
LCR	liquidity coverage ratio
Q&As	question and answer documents

1. Executive summary

1.1 Background

The liquidity coverage ratio (LCR) has been applicable in the European Union (EU) since 1 October 2015, and the LCR's full implementation at a minimum of 100% became effective in January 2018, which put an end to any national provisions in the area of liquidity requirements (Article 412(5) of the Capital Requirements Regulation (CRR)¹). Commission Delegated Regulation (EU) 2015/61 (LCR Delegated Regulation)² contains the specifications of the LCR. The LCR Delegated Regulation sets out a material number of national discretions to be exercised by competent authorities when implementing the LCR requirements, and envisages some leeway to credit institutions³ in the assessment of some material LCR items.

Against this background and as per the European Banking Authority (EBA) monitoring duties, with a view to contributing to a consistent application of EU law and promoting common supervisory approaches and practices in this area, the practical implementation of the LCR has been monitored, with particular attention paid to the items highlighted above.

The analysis focused on those LCR items for which material differences have been observed in their implementation across jurisdictions and which have thus had a significant impact on the uniform application of the LCR. These differences have been observed in the identification and quantification of wholesale deposits received that can benefit from the outflow preferential treatment of operational deposits⁴ and in the definition of 'material penalty' in the context of retail deposits maturing beyond 30 days that can be excluded from outflows⁵. In addition, other implementation issues have been observed, including in the recognition of inflows from maturing high-quality liquid assets (HQLA), in optionality and contingent inflows, in interbank swaps of retained covered bonds or asset-backed securities (ABS), in the time dimension of the LCR and in items subject to the notification process.

The general objective of the EBA monitoring work in the area of liquidity is to foster a higher degree of harmonisation in the implementation of the LCR in the areas where divergent practices have been observed, partly due to insufficient clarity of the regulatory provisions. More precisely, the purpose of this report is to:

¹ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p.1): <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0575&from=EN>

² Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions (OJ L 11, 17.1.2015): <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R0061&from=EN>

³ This report refers to credit institutions and banks interchangeably.

⁴ Article 27 of the LCR Delegated Regulation.

⁵ Article 25(4)(b) of the LCR Delegated Regulation.

- outline the EBA’s observations on some aspects of LCR implementation;
- outline the EBA’s views on the assessment of some observed practices;
- identify best practices and/or areas for which further guidance for banks and supervisors might be necessary, while providing some guidance for some of the areas monitored to date; and
- underline areas for which further monitoring is ongoing.

Methodology

The EBA has used, as a primary source, the data reported by banks under the supervisory reports (LCR common reporting (COREP) reports), complemented by some qualitative analyses and observations reported by competent authorities on the basis of their experience of liquidity risk supervision.

The quantitative information used for the purposes of this report is based on supervisory reporting data from June 2018 from a sample of credit institutions whose LCR COREP reports are received by the EBA on a regular basis in line with Article 415(4) and (5) of the CRR. This sample, determined following the criteria set out in the ‘Decision of the European Banking Authority on reporting by competent authorities to the EBA’ of 23 September 2015⁶, was composed of 192 banks as of 30 June 2018.

Table 1 Number of banks in the sample by jurisdiction as of 30 June 2018

AT	7	FR	12	LV	3
BE	7	GB	23	MT	4
BG	3	GR	4	NL	6
CY	4	HR	3	NO	3
CZ	3	HU	3	PL	3
DE	20	IE	12	PT	6
DK	4	IS	3	RO	3
EE	4	IT	11	SE	8
ES	12	LT	3	SI	4
FI	4	LU	7	SK	3

The analysis in this report differentiates between ‘larger institutions’ and ‘smaller institutions’. Larger institutions include those identified in the scope of the EBA Guidelines on disclosure of indicators of global systemic importance⁷, which intends to cover all EU institutions that are

⁶

<http://www.eba.europa.eu/documents/10180/16082/EBA+DC+090+%28Decision+on+Reporting+by+Competent+Authorities+to+the+EBA%29.pdf/9beaf5be-2624-4e36-a75b-b77aa3164f3f>

⁷ <https://eba.europa.eu/regulation-and-policy/own-funds/guidelines-for-the-identification-of-global-systemically-important-institutions-g-siis->

potentially systemically relevant, with a leverage ratio exposure measure above EUR 200 billion. Within the sample, 35 banks are defined as larger institutions⁸. Smaller institutions make up the rest of the institutions in the sample. The sample represents around 75% of the total assets of the EU banking system⁹.

The business models of 171 banks within the sample have been identified. Therefore, the report uses a reduced sample when describing business models. Table 2 describes the business models used.

Table 2: Description of business models

Business model type	Description	Number of banks
Automotive and consumer credit banks	Banks specialising in originating and/or servicing consumer and/or automotive loans to retail clients	5
Building societies	Banks specialising in the provision of residential loans to retail clients	3
Central counterparties	Banks specialising in setting trading accounts, clearing trades, collecting and maintaining margin monies, regulating delivery and reporting trading data	1
Cross-border universal banks	Cross-border banking groups engaging in several activities including retail, corporate and investment banking and insurance	47
Custody banks	Banks specialising in offering custodian services (i.e. they hold customers' securities in electronic or physical form for safe keeping to minimise the risk of loss). These banks may also provide other services, including account administration, transaction settlements, collection of dividends and interest payments, tax support and foreign exchange	7
Locally active savings and loan associations/cooperative banks	Banks focusing on retail banking (payments, savings products, credit and insurance for individuals or small and medium-sized enterprises) and that operate through a decentralised distribution network, providing local and regional outreach	9
Local universal banks	Banks specialising in originating and/or servicing consumer loans to retail clients and small and medium-sized enterprises	74
Merchant banks	Banks engaging in financing domestic and international trade by offering products such as letters of credit, bank guarantees and collection and discounting of bills	2
Mortgage banks including pass-through financing mortgage banks	Banks specialising in directly originating and/or servicing mortgage loans	7
Other specialised banks	Other specialised banks such as promotional banks and ethical banks	5

⁸ Of which 10 are global systemically important institutions.

⁹ Some data might be duplicated, for example cases of EU cross-border groups for which the subsidiaries also reported at an individual level in their own jurisdiction. However, this is not expected to distort the results and conclusions of this report and is necessary to ensure that the sample represents all Member States.

Business model type	Description	Number of banks
Public development banks	Banks specialising in financing public sector projects and/or the provision of promotional credit or municipal loans	10
Security trading houses	Banks facilitating trading done in derivatives and equities markets by guaranteeing the obligations in the contract agreed between two counterparties and/or by holding securities and other assets for safe keeping and record keeping on behalf of corporate or individual investors	1

Quantitative description is provided for all of the banks and also by business model (where relevant), size and complexity. Quantitative description is particularly useful when discussing operational deposits and excluded retail deposits from outflows. A priori, it might be presumed that larger institutions will be more affected by these implementation issues than banks with specialised business models, which would not be especially affected. While the analysis included several dimensions, the most relevant one did seem to be the size dimension for the issues under investigation.

Qualitative supervisory input from all of the competent authorities in the EU has also been used. This information is mainly composed of specific rules or guidance issued by competent authorities and approaches observed in practice.

Feedback from the industry has also been taken into account. Roundtables with banking associations, surveys of credit institutions and a public hearing have been organised to understand the approaches undertaken in practice and to gain input on the guidance to be provided.

1.2 The EBA's observations and main conclusions

Observations and conclusions have been drawn for the different items analysed in this report. It should also be recalled that the LCR became applicable relatively recently (October 2015), and the first reporting date for the LCR was even more recent (September 2016). Therefore, it was expected that a relatively high number of issues would be observed during the assessment of the implementation of the liquidity standards in the EU and of the corresponding reporting requirements.

As detailed further in the report, through its first attempt at monitoring LCR implementation in the EU, the EBA has identified areas in which further guidance is deemed useful for banks and supervisors in order to foster a common understanding and harmonisation of the application of the liquidity standard, while at the same time reducing some issues as regards the level playing field. In particular, guidance is provided by the EBA as regards operational deposits and retail deposits excluded from outflows. The EBA is also providing guidance to supervisors with regard to notifications on additional liquidity outflows.

In addition, the EBA has identified areas that may need further attention from supervisors in their ongoing supervision of liquidity risks, particularly the time dimension of the LCR (comparison

between end-of-month LCR and intra-month LCR values) and cases in which banks are swapping some retained own securities.

This report contains specific guidance for credit institutions and supervisors on different topics. The guidance identifies good and prudent practices in the application of several provisions of the LCR Delegated Regulation for which, currently, the degree of discretion is such that divergent and undesired results are reached, jeopardising the consistent application of those provisions and the level playing field. The EBA intends to follow a pragmatic approach to addressing these issues by publishing this guidance, with the expectation that credit institutions and supervisors will follow it. The issues flagged in this report and the application of this guidance will be monitored in the future as the EBA continues its monitoring activities on an ongoing basis. Based on the results of this monitoring exercise, the EBA might consider developing other more formal legal instruments at its disposal in the future if considered necessary.

Operational deposits

The report refers to operational wholesale deposits, defined as those received for the purposes of obtaining clearing, custody, cash management or other comparable services in the context of an established operational relationship, as well as those received in the context of an established operational relationship other than that¹⁰. Only the part of the operational wholesale deposits that is required for the provision of operational services can be treated as operational.

There is a significant difference in the LCR depending on whether wholesale deposits received are treated as operational or non-operational, since the outflow rates are materially lower for those treated as operational deposits. Wholesale deposits treated as operational deposits are assumed to be less vulnerable to significant deposit withdrawals during a period of combined idiosyncratic and market-wide stress than those treated as non-operational deposits. The amount of wholesale deposits and their outflows reported by the banks in the sample is generally significant.

The LCR Delegated Regulation does not provide sufficiently detailed criteria to identify, on the one hand, which specific transactions should be identified as operational deposits and, on the other hand, the transaction amounts that should be considered 'excess operational deposits'¹¹, which the Regulation requires be treated as non-operational. This may lead to the use of inconsistent or imprudent identification approaches, which could jeopardise the harmonised implementation of the LCR and raise some issues regarding the level playing field across credit institutions and jurisdictions.

This report provides some clarification to credit institutions and competent authorities, fleshing out the general aspects of a couple of methods by providing non-exhaustive examples of prudent approaches and good practices for estimating the 'excess operational deposits' within the operational deposits, which need to be treated as non-operational. These approaches are expected

¹⁰ Article 27(1)(a) and (c) of the LCR Delegated Regulation.

¹¹ In accordance with Article 27(4) of the LCR Delegated Regulation: 'Funds in excess of those required for the provision of operational services shall be treated as non-operational deposits'. The report refers to these funds in excess as 'excess operational deposits' from now on.

to be applied in a proportionate manner by smaller credit institutions. They are meant to provide banks and supervisors with a transparent benchmark for a consistent and prudent approach. These approaches estimate excess operational deposits on the basis of historical observations of either payments made or balances maintained for the necessary operational services of the deposit.

The EBA guidance also provides some examples of specific transactions that, according to the practices analysed so far and provided that the conditions set forth by the LCR Delegated Regulation are met, should fall under operational deposits (cash management, custody or clearing activities) and others that should not.

Excluded retail deposits from outflows¹²

Article 25(4) of the LCR Delegated Regulation allows credit institutions to exclude from the calculation of outflows those retail deposits maturing after 30 calendar days when the depositor is not legally allowed to withdraw the deposit before 30 calendar days are up or when the depositor can do so only by paying a material penalty. Therefore, the exemption responds to either legal or economic constraints.

Excluding retail deposits from outflows has a significant impact on the LCR of banks. This is because the outflow rate applicable to them would be reduced significantly (expected to be at least 10% or even higher at 0%). The lack of a concrete definition of material penalty in Article 25(4) of the LCR Delegated Regulation may lead to banks using different implementation approaches to assess the materiality of the penalty applicable, resulting in very different outcomes as regards the amount that can be withdrawn early. This jeopardises the level playing field across banks in the EU. For example, some banks might determine that the penalty should exceed the amount of interest paid or accrued at the moment of early withdrawal, whereas others might consider this not strictly necessary.

The report discusses good practices that could serve as a benchmark for the application of Article 25(4) of the LCR Delegated Regulation. These good practices are based on whether or not there is some evidence that outflows are not expected to happen. The report is intended to contribute to a common understanding of the LCR and to a level playing field across the EU.

Other implementation issues observed

Recognition of inflows stemming from maturing HQLA

The EBA has observed cases in which assets, recognised as HQLA and subject to high haircuts, have been reclassified as non-HQLA during the last 30 calendar days of their lifetime under the rationale that some operational requirements are no longer met.

The impact of this reclassification on the LCR might be material. Banks might compute inflows from non-HQLA maturing within 30 calendar days, with an applicable 100% inflow rate, that are more

¹² The report refers to these deposits as 'excluded retail deposits' from now on.

favourable than their liquidity value assessed after applying the cited high haircuts when included in HQLA.

For these reasons, it should be fully justified to supervisors if and how the relevant operational requirements are no longer being met precisely during the last 30 calendar days of the lifetime of securities.

Optionality and contingent inflows

Generally, inflows whose materialisation depends on the exercise of an option should not be considered eligible in the LCR. Under Article 32(1) of the LCR Delegated Regulation, inflows are required to be contractual. This approach is also supported by prudential considerations.

By contrast, outflows happening upon the exercise of an option should be integrated based on the expectations that the option will be exercised (Article 22(2) of the LCR Delegated Regulation). For prudential reasons, the option should be expected to be exercised in a stress scenario and the relevant outflow rate should therefore apply.

This approach has been clarified in a number of EBA question and answer documents (Q&As) on specific transactions of this kind, in which questions were raised on whether or not some inflows should be considered contingent and on how contingent outflows should be treated.

Interbank swaps of retained covered bonds or ABS

Retained own securities are not eligible for HQLA. However, there seem to be cases in which two banks swap retained own securities (covered bonds and ABS) and then each of the banks recognises the assets received in the swap as HQLA.

Strictly speaking, the assets received could be considered HQLA if they meet Articles 7 and 8 of the LCR Delegated Regulation on general and operational requirements, belong to any category of liquid assets within Chapter 2 of Title II of the LCR Delegated Regulation and fall within the caps envisaged in Article 17 of that Regulation.

However, in cases in which the swapped assets are always retained from the issuance date and are not placed in the market before being swapped, particular attention should be paid to the compliance with the operational criteria requiring pricing evidence or tested marketability of the assets received in a swap before they are considered eligible for HQLA.

Time dimension of the LCR

Cases have been observed in which, due to occasional transactions with material incoming cash flows, end-of-month LCR values are higher than intra-month values.

In addition, liabilities with evergreen contractual maturity beyond 30 calendar days¹³ containing unwritten/informal arrangements for early withdrawal might trigger cliff effects for different time horizons.

These types of transactions should be closely monitored and their risks assessed. Institutions are reminded to immediately notify the relevant competent authority if the LCR falls or is reasonably expected to fall below 100% at any time. Supervisors are reminded that the maturity ladder in the Implementing Technical Standards (ITS) on additional liquidity monitoring metrics (ALMM)¹⁴ contains daily and weekly granularity to further assess the risks of these practices on a case-by-case basis for different survival periods.

1.3 Feedback from the industry

The EBA has held various exchanges with stakeholders on the objectives and main features of the work conducted as well as on preliminary conclusions. An informal technical discussion with professional associations and selected banks was held in February 2019 and the EBA Banking Stakeholder Group has been consulted on two occasions (April 2018 and February 2019). Written comments were subsequently received and addressed to refine or clarify some methodological aspects in the relevant parts of this report, where deemed appropriate. Participants have generally welcomed and supported the EBA's work on the aspects included in this report, while additional areas that the EBA could further clarify in the future were also mentioned.

In addition, a public hearing was organised on 8 July 2019 in order to present the rationale of the work and explain the way forward.

The EBA will continue to hold exchanges on a regular basis with stakeholders while progressing with its monitoring work.

1.4 Next steps

The EBA intends to regularly monitor the implementation of the LCR for EU banks and update this report on an ongoing basis to set out its observations and provide further guidance, where necessary. This will include further scrutiny of the aspects mentioned in this first report, as well as new aspects. The EBA is, in particular, working on implementation related to Article 26 of the LCR Delegated Regulation, the LCR by significant currency and HQLA diversification.

While some guidance is already proposed for some areas monitored in this report, the EBA will further assess how this guidance will be used by banks and supervisors and consider taking further steps if needed (including some fully fledged products such as guidelines, recommendations, etc.), while continuing its monitoring of the aspects mentioned in this report.

¹³ These are liabilities that are formally renewed on a permanent basis as long as the maturity approaches 30 days and no early withdrawal option is formally contemplated.

¹⁴ Commission Implementing Regulation (EU) 2017/2114 of 9 November 2017 amending Implementing Regulation (EU) No 680/2014 as regards templates and instructions (OJ L 321, 6.12.2017): <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R2114&from=EN>

In addition, the EBA is paying attention to the notifications sent to the EBA by competent authorities, in particular those that may have a significant impact on the LCR calculation. The EBA is providing, where necessary, guidance to supervisors, for example as regards Article 23 of the LCR Delegated Regulation.

The EBA intends to use this monitoring exercise as a tool to assess if changes are needed to the LCR COREP reports. For instance, the EBA has already built on this first monitoring exercise to propose some changes to the ITS on the LCR (i.e. the removal of some memo items that are deemed to have filled their role and are no longer providing useful information); these changes were consulted on in September/October 2018.

The EBA will engage on a regular basis with stakeholders to explain its monitoring work, collect additional information on implementation practices and discuss where guidance is deemed to be most helpful.

2. LCR implementation issues — observations and policy guidance

2.1 Operational deposits — Article 27 of the LCR Delegated Regulation

2.1.1 Background

Legal background

1. In accordance with the LCR Delegated Regulation, wholesale operational deposits (apart from those in the context of an institutional protection scheme or a cooperative network) are mainly:
 - a) deposits maintained by the depositor in order to obtain clearing, custody, cash management or other comparable services in the context of an established operational relationship from the credit institution which is critically important to the depositor (Article 27(1)(a) and 27(4) of the LCR Delegated Regulation).
 - b) deposits maintained by the depositor in the context of an established operational relationship other than that mentioned in point a) above (Article 27(1)(c) of the LCR Delegated Regulation)¹⁵.
2. The operational deposits referred to in paragraph 1 must meet the conditions that are specified in Article 27(4) and (5) of the LCR Delegated Regulation:
 - a) They shall have significant legal or operational limitations that make significant withdrawals within 30 calendar days unlikely.
 - b) Funds in excess of those required for the provision of operational services shall be treated as non-operational deposits.
 - c) Correspondent banking deposits and prime brokerage deposits shall not be considered operational deposits.

Clearing, custody, cash management and comparable services

3. The identification of specific transactions under cash management, clearing and custody activities in the context of operational deposits referred to in Article 27(1)(a) of the LCR Delegated Regulation does not seem so straightforward. In the past, some clarification was

¹⁵ The report refers to this category of operational deposits as 'other operational deposits' from now on.

provided via [Q&A 2013 150](#) aligning the definitions of those activities with the definitions set out in the Basel LCR standards¹⁶. In this Q&A, it is specified that:

- a) Cash management services refers to those products and services provided to a customer to manage its cash flows, assets and liabilities, and conduct financial transactions necessary to the customer's ongoing operations. Such services are limited to payment remittance, collection and aggregation of funds, payroll administration, and control over the disbursement of funds.
 - b) A clearing relationship, in this context, refers to a service arrangement that enables customers to transfer funds (or securities) indirectly through direct participants in domestic settlement systems to final recipients. Such services are limited to the following activities: transmission, reconciliation and confirmation of payment orders; daylight overdraft, overnight financing and maintenance of post-settlement balances; and determination of intra-day and final settlement positions.
 - c) A custody relationship refers to the provision of safekeeping, reporting, processing of assets or the facilitation of the operational and administrative elements of related activities on behalf of customers in the process of their transacting and retaining financial assets. Such services are limited to the settlement of securities transactions, the transfer of contractual payments, the processing of collateral, and the provision of custody related cash management services. Also included are the receipt of dividends and other income, client subscriptions and redemptions. Custodial services can furthermore extend to asset and corporate trust servicing, treasury, escrow, funds transfer, stock transfer and agency services, including payment and settlement services (excluding correspondent banking), and depository receipts.
4. However, in practice, cataloguing these transactions still remains challenging for many banks and supervisors, and guidance complementary to this Q&A is necessary.

Other operational deposits

5. The process of identifying other operational deposits in the context of an established relationship that could fall under Article 27(1)(c) of the LCR Delegated Regulation remains unclear for many banks and supervisors while directly drawn from Article 422(3)(c) of the CRR. There does not seem to be sufficient clarity on which specific services are expected to be considered in the context of an established relationship while not being clearing, custody or cash management services.

Excess operational deposits treated as non-operational deposits

6. The LCR Delegated Regulation treats as non-operational deposits those that could also be defined as excess operational deposits, i.e. the part of the operational deposit that is not

¹⁶ Paragraphs 101 to 103 of 'Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools' (Basel Committee on Banking Supervision, January 2013).

necessary for the provision of operational services and that subsequently will not receive the preferential outflow treatment envisaged for operational deposits.

7. Article 27(4) of the LCR Delegated Regulation states that ‘funds in excess of those required for the provision of operational services shall be treated as non-operational deposits’. In the same vein, the second subparagraph of Article 27(6) of the LCR Delegated Regulation, regarding other operational deposits, also provides that ‘Only that part of the deposit which is necessary to make use of the service of which the deposit is a by-product shall be treated as an operational deposit. The excess shall be treated as non-operational.’ The LCR Delegated Regulation specifies that these funds should be treated as non-operational deposits but does not provide enough clarity for their identification.
8. [Q&A 2016 2647](#) added some general lines that should be followed for the purposes of the identification of excess operational deposits, namely:
 - a) The institution should develop its own method to estimate these amounts, under the supervision of the relevant competent authority. Should the institution fail to do so, the entire deposit should be treated as non-operational.
 - b) The quantification method should use factors related to the nature of the operational service and the client’s usage of this service.

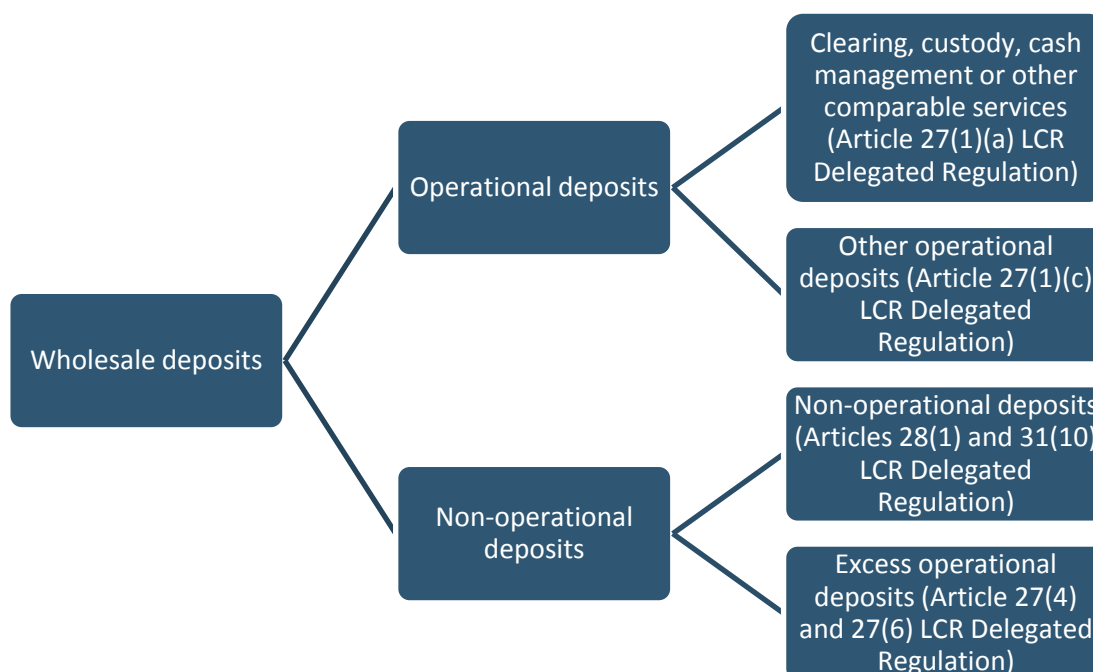
Reporting data and observed practices

9. Reporting data and observed practices show that the identification and classification of wholesale deposits as operational or non-operational is not easy and results in quite diverse situations across banks as a consequence of the uncertainties mentioned. Difficulties appear in practice in the identification of the specific categories of operational deposits and excess operational deposits.
10. The LCR Delegated Regulation envisages preferential outflow rates in the case of received wholesale deposits considered operational. Specifically, operational deposits trigger a 25% outflow rate (5% if covered by a deposit guarantee scheme (DGS)) versus a 40% (20% if covered by a DGS) or 100% outflow rate for non-operational deposits stemming from non-financial or financial customers, respectively.
11. Outflows from wholesale deposits have a material weight in LCR components, since they represent, in total, 46% of all outflows, of which 38% are for non-operational deposits and 8% are for operational deposits for the 192 banks in the sample. Owing to this weight and to the significantly different outflow rates applicable to operational and non-operational deposits, the wrong classification of wholesale deposits has a significant impact on the LCR.

Operational versus non-operational deposits

12. The LCR reporting template on outflows¹⁷ treats operational deposits and non-operational deposits separately (with the latter also including funds in excess of those required for the provision of operational services, namely excess operational deposits). Within the operational category, it also differentiates between those in the context of clearing, custody, cash management or other comparable services and ‘other operational deposits’ (points (a) and (c) of Article 27(1) of the LCR Delegated Regulation, respectively) (Figure 1).

Figure 1: Treatment of wholesale deposits — determination of outflows



On average, 34% of all wholesale deposits were classified as operational (in the EBA sample as of 30 June 2018); in addition, 35% of wholesale deposits were classified as operational by larger institutions, which was somewhat higher than the proportion by smaller institutions (29%). While there is less dispersion for larger institutions, the figures are quite different across banks, as shown in Figure 2. This figure depicts, on a bank-by-bank basis, the proportion of wholesale deposits that are being treated as operational by larger institutions and by smaller institutions in the sample.

13. Larger institutions account for almost 85% of the operational deposits of all banks in the sample. More smaller institutions (46%) than larger institutions (11%) report no operational deposits.

14.

¹⁷ Annex XXII (template C 73.00) of Commission Implementing Regulation (EU) No 680/2014, as amended by Commission Implementing Regulation (EU) 2016/322 of 10 February 2016 ('ITS on LCR supervisory reporting'): <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R0322>

15. Figure 3 shows how smaller institutions more often have a low percentage of operational deposits among wholesale deposits, whereas larger institutions typically have a larger percentage of operational deposits among wholesale deposits. However, there are also smaller institutions with material proportions of operational deposits.

Figure 2: Operational deposits by bank (as a percentage of total wholesale deposits), as of 30 June 2018

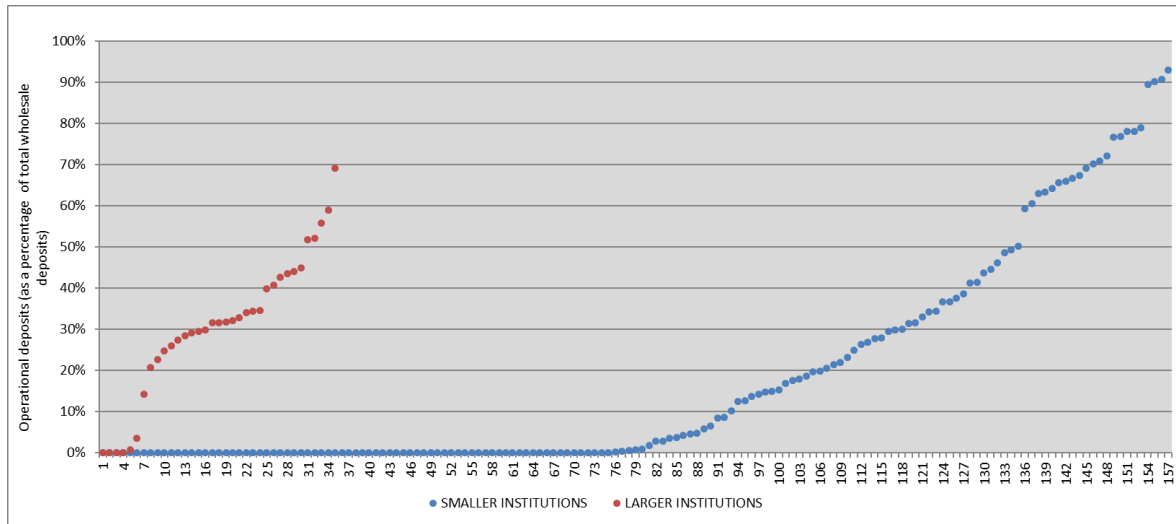
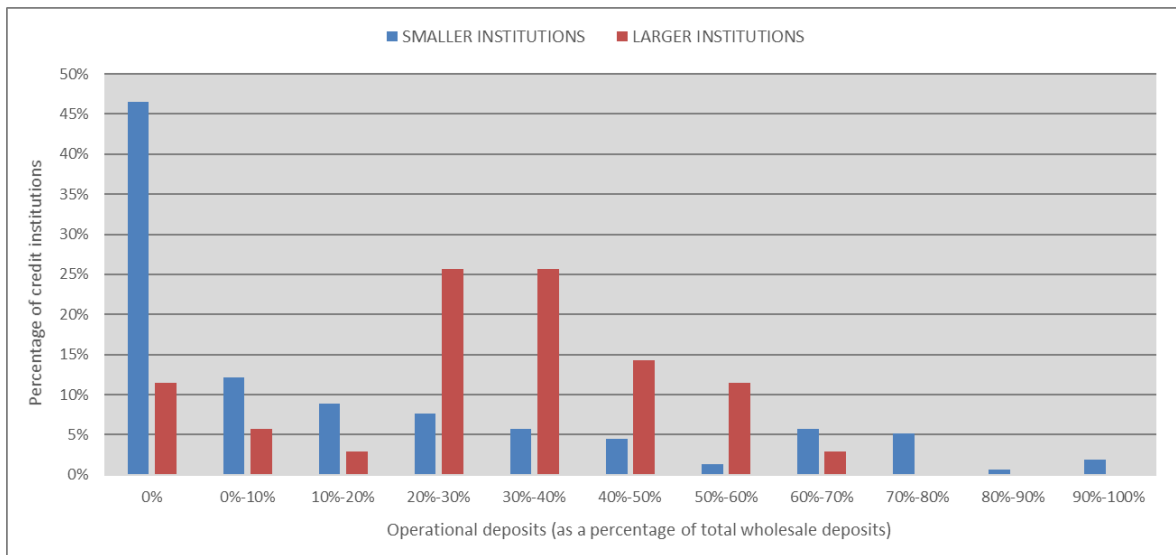
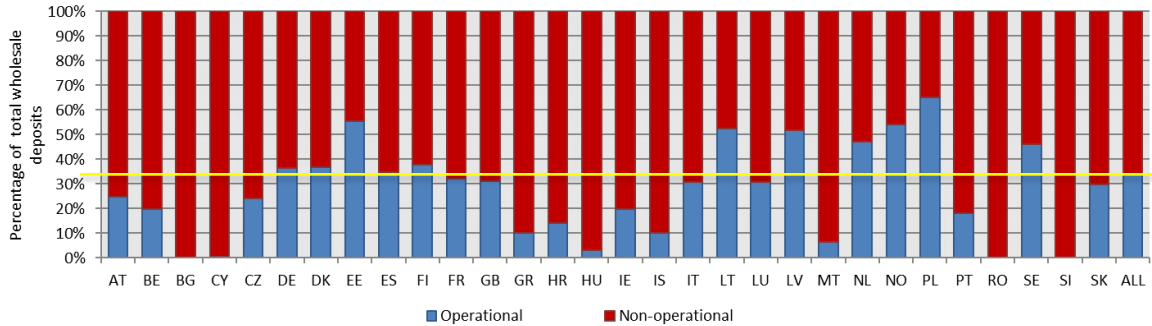


Figure 3: Operational deposits — larger institutions versus smaller institutions, as of 30 June 2018



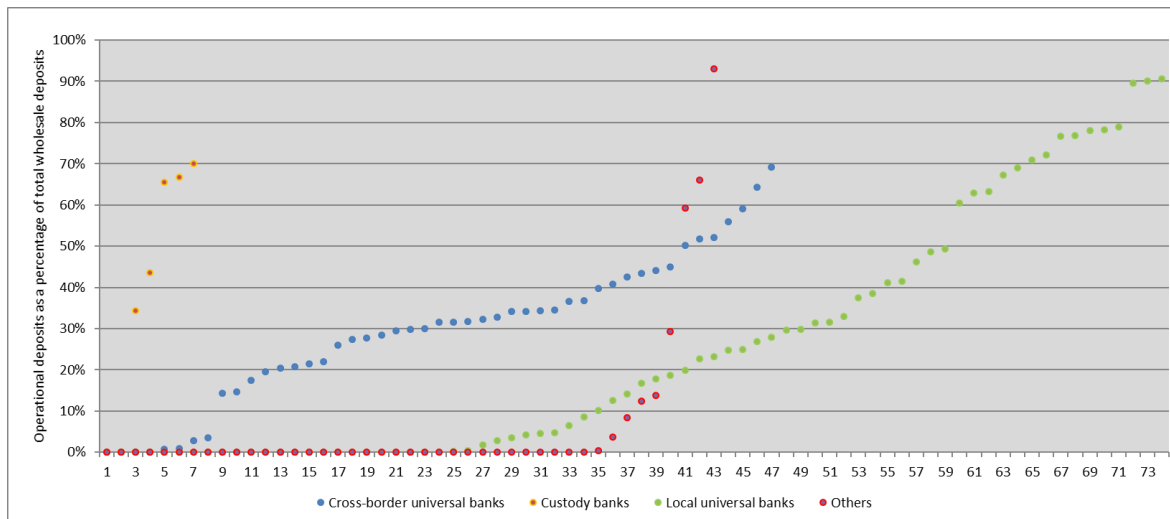
16. Figure 4 shows the composition of wholesale deposits, as either operational or non-operational deposits, by jurisdiction. It can be seen from this figure that the percentage of operational deposits ranges from 0% to 65% across jurisdictions.

Figure 4: Operational and non-operational deposits by jurisdiction (as a percentage of total wholesale deposits), as of 30 June 2018



17. When looking at banks by business model, 84% of all operational deposits are reported by cross-border universal banks. Local universal banks report 9% of all operational deposits. The presence of operational deposits in the other business models is very limited (except in some custody banks). Figure 5 shows the proportion of operational deposits by bank and business model.

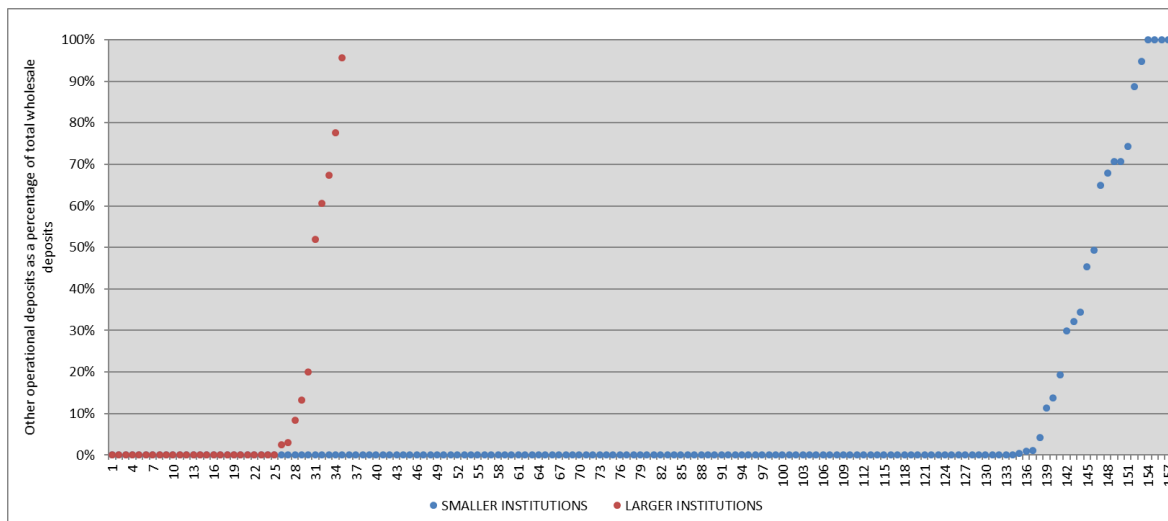
Figure 5: Operational deposits by bank and business model (as a percentage of total wholesale deposits), as of 30 June 2018



18. Transactions identified under Article 27(1)(a) of the LCR Delegated Regulation (clearing, custody or cash management services) are the most common and represent around 81% of operational deposits in the sample.

19. Transactions under Article 27(1)(c) of the LCR Delegated Regulation (other operational deposits) are also relatively common considering the uncertainties regarding this category, representing nearly 16% of all operational deposits, and are mainly concentrated in larger institutions (93%). Figure 6 shows the proportion of these deposits on a bank-by-bank basis.

Figure 6: Other operational deposits by bank (as a percentage of total operational deposits), as of 30 June 2018



20. Based on the reporting data and additional qualitative information collected, it can be observed that some transactions reported under Article 27(1)(c) of the LCR Delegated Regulation (other operational deposits) should have been reported under Article 27(1)(a) of the LCR Delegated Regulation (on operational deposits for clearing, custody or cash management or other comparable services). Other transactions should not have been a priori reported as operational deposits at all.

21. From the information collected, it appears that in some banks:

- there could be a misunderstanding, namely that all operational deposits from non-financial customers should be reported as other operational deposits;
- there might be uncertainties regarding the definitions of cash management, custody and clearing services and, for this reason, all operational deposits are being reported as other operational deposits;
- it is considered that deposits stemming from central government or local authorities should be reported as other operational deposits;
- deposits received in the context of the centralised liquidity management that the bank conducts are being treated as operational deposits;
- intragroup deposits are being treated as operational deposits.

Excess operational deposits

22. The LCR COREP reporting templates do not currently identify the excess amount as a separate item. It is proposed that dedicated rows be introduced in the upcoming [updated LCR supervisory reporting templates](#) for proper monitoring to take place.
23. The practices observed show that, generally, banks with high-value operational deposits implement approaches that maximise the amount of the deposit that is necessary for the provision of operational services, in order to benefit from lower outflow rates. By contrast, banks in which these deposits are limited in value generally do not seem to find it economically worthwhile to develop an approach to estimate the amount that is necessary for the provision of operational services and instead consider all deposits non-operational.
24. The approaches observed consist, in most cases, of estimating the amount that is necessary for the provision of operational services to a given customer and then calculating the excess amount as the difference between the former amount and the total value of operational deposits. The approaches were based on different variables (outflows, deposit balances, etc.) while different metrics (minimum, mean, etc.) were used to estimate the current amount necessary for the provision of operational services through different time horizons.

Conclusion

25. The fact that the LCR Delegated Regulation does not provide sufficiently detailed criteria to identify specific transactions under Article 27(1)(a) or (c) and to determine the amount of excess operational deposits results in a wide variety of practices across banks in the classification of wholesale deposits to be treated as operational or non-operational, which, in turn, has a significant impact on the LCR.
26. In the absence of a harmonised approach, the use of imprudent approaches could lead to an overestimated LCR and this could affect the level playing field across banks. As a result, the EBA sees benefits in providing some guidance in this area, as explained below.

2.1.2 EBA guidance on operational deposits

27. Guidance has been developed on two aspects: (i) clarifying the identification of operational deposits and (ii) providing non-exhaustive examples of good practices in quantifying the amount of excess operational deposits.

EBA guidance with regard to the identification of specific categories of operational deposits and the identification of excess operational deposits

28. Wholesale deposits from both financial and non-financial customers may fall under the category of operational deposits, referred to in Article 27(1)(a) of the LCR Delegated Regulation, whereas the category of other operational deposits under Article 27(1)(c) covers deposits from non-financial customers in particular. This is also in line with the instructions of the ITS on LCR supervisory reporting, rows 130 and 190 in template C 73.00.

29. The following constitutes a non-exhaustive list of examples of products that could fall under Article 27(1)(a) subject to the conditions in Article 27(4) of the LCR Delegated Regulation: separate accounts established for custodian banks for securities settlement only, cash-pooling accounts, deposits provided by customers in the context of project finance where the deposit account is used centrally for all project-related cash flows, deposits specifically designated for the collection and payment of taxes on a recurrent basis, bill remittances, payment of salaries, payment of social security contributions and income from cheque remittances.
30. Operational deposits need to meet the conditions in Article 27 of the LCR Delegated Regulation; the mere fact that deposits stem from central government, regional government or local authorities is not sufficient for them to be classified as operational.
31. Deposits received in the context of centralised liquidity management are not expected to qualify as operational deposits, since they are expected to, at least partially, incorporate funds for purely financial investment purposes and therefore the criteria under Article 27(6)(a) and (b) of the LCR Delegated Regulation, on the remuneration of the account and incentives for the depositor, are not expected to be met.
32. The mere fact that the deposit is an intragroup deposit is not sufficient for it to qualify as operational. In this respect, the application of preferential outflow and inflow rates for intragroup transactions in the context of credit and liquidity facilities is specifically considered under Articles 29 and 34 of the LCR Delegated Regulation.
33. For the identification of excess operational deposits, the guidance also includes a description of the general aspects of two methods given as non-exhaustive examples of appropriate approaches and good practices. The guidance is expected to be implemented by banks under the supervision of the relevant competent authority ([Q&A 2016 2647](#)). These approaches intend to give banks and supervisors a transparent benchmark of a harmonised prudent approach. These methods are outlined below and are expected to be applied in a proportionate manner by smaller institutions, with regard to the exhaustiveness of their specificities.

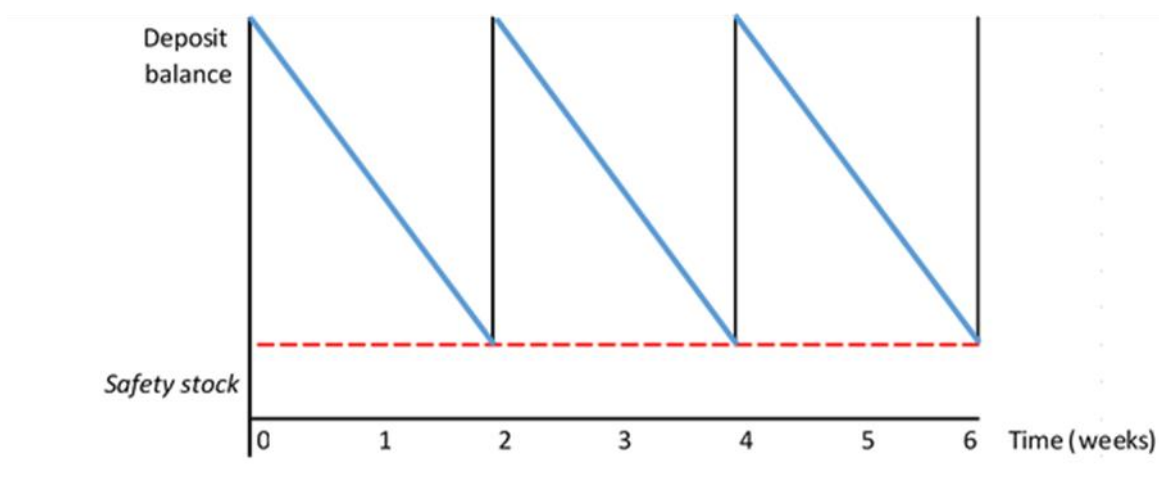
Method 1 — an approach based on deposit balance

34. This methodology takes some of the basic aspects of cash management models in corporate finance (Baumol-Allais-Tobin model, Miller-Orr model) and adapts them to the specificities of the client's trade cycle¹⁸.
35. Overall, cash management strategies in large corporates are based on holding a specific amount of available bank deposits, to cover shortfalls of inflows from outflows, to meet the general payments in the context of their ongoing operations (payrolls, supplies, etc.).

¹⁸ Alternatively, the deposit activity cycle can be used, whereby the depositor should be able to demonstrate to the supervisor, upon request, that the identification of the trade cycle is a very complex and highly burdensome task.

36. Corporates make use of these deposits during the trade cycle to face their ongoing payments (blue lines in Figure 7). Once these deposits have been fully used during a trade cycle, corporates then need to replenish these deposits for the next trade cycle.
37. Corporates are expected to place deposits of larger amounts than those strictly needed for their ongoing payments during the trade cycle. This is done for safety reasons to cover potential unscheduled payments. These safety balances or safety stocks are not expected to be used and, strictly speaking, are not necessary for their ongoing payments.
38. Figure 7 shows an example of the use by corporates of deposit balances over 2-week trade cycles.

Figure 7 Evolution of deposit balances



39. Banks might be interested in holding larger balances in scenarios of low interest rates, since, in such scenarios, the opportunity costs would be very low. Therefore, higher operational balances might be expected under those scenarios to cover more than a single trade cycle.
40. In the context of the LCR, the deposit balances used for ongoing payments by corporates (blue lines in Figure 7) would fall within the definition of eligible operational deposits to benefit from the preferential outflow treatment envisaged in the LCR Delegated Regulation. Their proneness to withdrawal in a normal scenario is not expected to differ from that in stress scenarios and this can be measured by the preferential rate envisaged in the Regulation. The safety balance, however, could be considered as the excess amount of operational deposits that would not benefit from the preferential outflow treatment. This is because, even though it is expected to remain stable in a non-stress scenario, the safety stock is the part of the deposit balance that corporates are expected to be able to use under stress, since it is not expected to jeopardise their business continuity.

41. Safety balances could be considered as the amounts remaining over time across various trade cycles and could be estimated to some extent (via different metrics such as means, minimum value, etc.) within a sample of historical observations of deposit balances.
42. For custodian banks, this methodology could be adapted to collect data on and evaluate the relationship between account balances and assets under custody. Investment funds are expected to place deposits of larger amounts than those strictly needed for their ongoing payments to ensure the smooth settlement of their transactions.

Method 2 — an approach based on operational payment

43. This methodology looks into historical daily payments made for operational services in a corporate (or assets under custody) during a certain period of time related to its trade cycle¹⁹.
44. Corporates focus on holding available bank deposits of the amount necessary to cover ongoing payments during a trade cycle. This ensures the continuity of their business.
45. This necessary amount would be estimated from the observations of historical daily payments referred to previously. It could be a rolling average of cumulative payments across various periods of time related to trade cycles.
46. This amount would be considered equal to the amount necessary for the provision of operational services in the context of LCR operational deposits and would subsequently benefit from the preferential LCR outflow treatment.
47. The excess operational deposits, which would not benefit from the preferential outflow rate, would result from the difference between the total balance of operational deposits and the amount necessary for rendering operational services, as estimated in the previous paragraphs.
48. Both of these methods would require banks to provide evidence that an assessment of cash management on a client-by-client basis or by client type (financial versus non-financial customers, by business line, by client behaviour or considering the type of operational services: clearing, custody or cash management) is available to identify the excess amount of operational deposits.

¹⁹ Alternatively, the deposit activity cycle can be used, whereby the depositor should be able to demonstrate to the supervisor, upon request, that the identification of the trade cycle is a very complex and highly burdensome task.

2.2 Retail deposits excluded from outflows — Article 25(4) of the LCR Delegated Regulation

2.2.1 Background

Legal background

49. Article 25(4) of the LCR Delegated Regulation allows credit institutions to exclude from the calculation of outflows retail deposits maturing after 30 calendar days when the depositor is not legally allowed to withdraw the deposit before the 30 calendar days are up or when the depositor can do so only by paying a penalty, as further delimited in Article 25(4)(b) of the LCR Delegated Regulation²⁰. Therefore, the exemption responds to either legal (Article 25(4)(a) of the LCR Delegated Regulation) or economic constraints (Article 25(4)(b) of the LCR Delegated Regulation).

50. In the context of the economic constraints (Article 25(4)(b) of the LCR Delegated Regulation):

- When the first part of that provision states that ‘the depositor has to pay a penalty that includes the loss of interest between the date of withdrawal and the contractual maturity date’, the interpretation that the amount of the penalty to be effectively paid must include at least the interest that would have been accrued between the date of withdrawal and the contractual maturity date, would not be consistent with the second part of the provision where it might be sufficient for the material penalty to be limited up to the amount of interest due for the time elapsed between the date of deposit and the date of withdrawal.
- The second part of that provision states: ‘plus a material penalty that does not have to exceed the interest due for the time that elapsed between the date of deposit and the date of withdrawal’. Here the expression ‘does not have to exceed...’ literally means ‘must (or does) not necessarily exceed’. However, some language versions of the LCR Delegated Regulation have translated the term ‘does not have to’ by ‘shall not exceed’, ‘does not exceed’ or ‘not to exceed’. Given the divergence between the language versions of this provision, the European Court of Justice has consistently held that, in such cases, the provision in question must be interpreted with reference to the purpose and general scheme of the rules of which it forms part²¹.

According to the most liberal reading (‘does not have to exceed’), the provision would assume that a material penalty might range from at least a part of the interest due for the time elapsed between the date of the deposit and the date of the withdrawal to the whole amount of that interest, but without excluding or prohibiting the setting of a material penalty exceeding the whole amount of that interest. In this way, the provision would

²⁰ ‘... the depositor has to pay a penalty that includes the loss of interest between the date of withdrawal and the contractual maturity date plus a material penalty that does not have to exceed the interest due for the time that elapsed between the date of deposit and the date of withdrawal’.

²¹ To name a few: Case 30/77, paragraph 14; Case C-449/93, paragraph 28; and Case C-236/97, paragraph 26.

sufficiently achieve the objectives pursued by the LCR Delegated Regulation (to capture the specific risk of early withdrawal of those deposits under a severe LCR stress scenario), without precluding the setting of a higher material penalty, if allowed under national law²².

The alternative reading ('shall not exceed') would assume that the LCR Delegated Regulation requires that a prudential requirement (the imposition by banks of a material penalty for early withdrawal of a term deposit in order to achieve more favourable treatment in the LCR) be translated into a private right or duty (the prohibition of contractually establishing a material penalty that exceeds the interest due for the time elapsed between the date of the deposit and the date of withdrawal), thus adding a conduct of business and/or consumer protection component, which would not be in line with the rationale of the LCR Regulation as a prudential regulation.

Reporting data and observed practices

51. The practices observed show different implementations of this provision by banks. The implementation ranges from cases in which banks do not apply it in practice, mainly due to the current low level of interest rates, which makes any interest-based penalty non-material, to cases in which a penalty not exceeding the interest accrued from the date of the deposit until the early withdrawal date could be considered material. There are other cases in which the application of the exemption can happen only if the penalty incorporates the accrued interest plus some non-accrued interests and thus reduces the amount of deposit to be withdrawn below the amount of the principal²³. Therefore, there are different approaches to implementing this provision in place without contradicting the object and purpose of the LCR Delegated Regulation.

52. Retail term deposits maturing after 30 calendar days are generally expected to be subject to the default outflow rates set out in Article 25 of the LCR Delegated regulation, i.e. 10% by default or higher (up to 20%) depending on their conditions. They are not expected to be stable retail deposits subject to 3-5% outflow rate, since they are not expected to be held in a transactional account (for the very reason that they mature after 30 calendar days) or, in some cases, to be part of an established relationship (e.g. if the duration of the depositor's relationship with the credit institution is under 12 months).

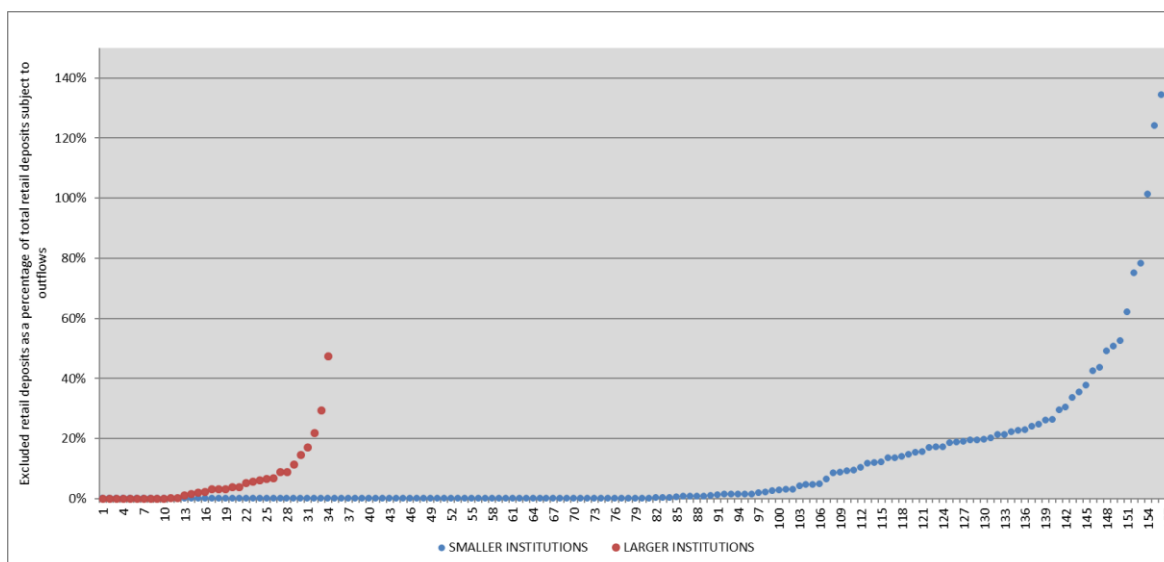
53. Therefore, the application of Article 25(4) of the LCR Delegated Regulation for these deposits, due to either the legal or the economic constraints cited, would exclude them from any outflow, which means that their outflow rate would be reduced in some cases by at least 10 percentage points (from 10%, at a minimum, to 0%). Banks are not required to hold any HQLA for 'excluded retail deposits', meaning that the impact on the LCR is potentially significant. This is because no withdrawal is expected to happen under a severe LCR stress scenario.

²² Indeed, the inclusion of penalty clauses in cases of early termination of a term deposit is inherent to the legal nature of a 'term deposit' (its objective being to protect the purpose of the contract for the depositary institution in the case that the depositor decides to withdraw the deposit early or terminate the deposit before maturity), although in some Member States this practice is limited or even prohibited for conduct of business and/or consumer protection reasons.

²³ Original amount of the term deposit.

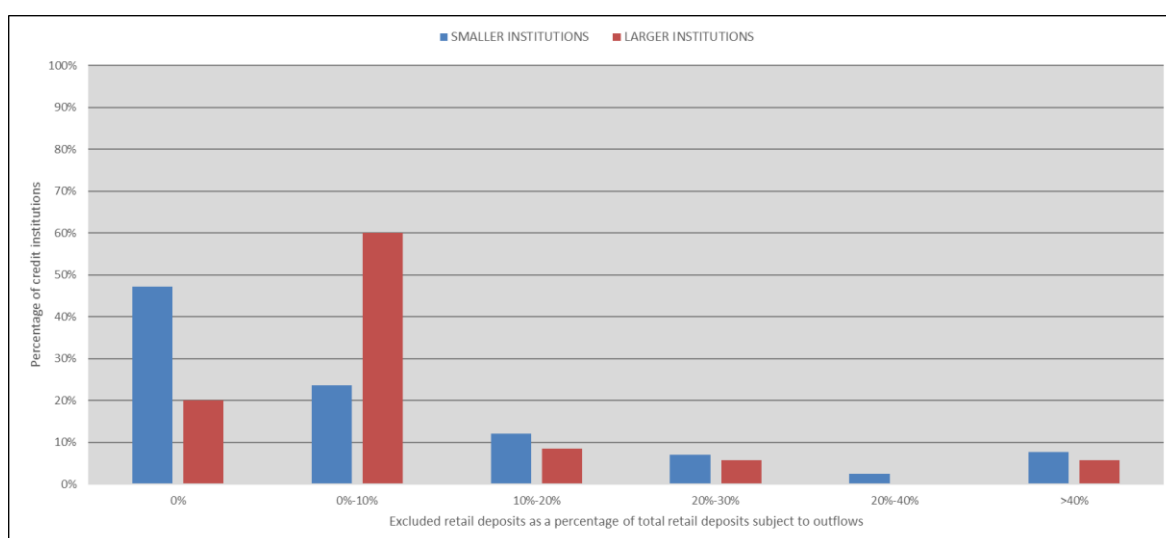
54. Figure 8 shows how much excluded retail deposits represent, as per Article 25(4) of the LCR Delegated Regulation, with respect to total retail deposits subject to outflows for each of the banks in the sample, either larger institutions or smaller institutions.

Figure 8: Excluded retail deposits on a bank-by-bank basis (as a percentage of retail deposits subject to outflows), as of 30 June 2018



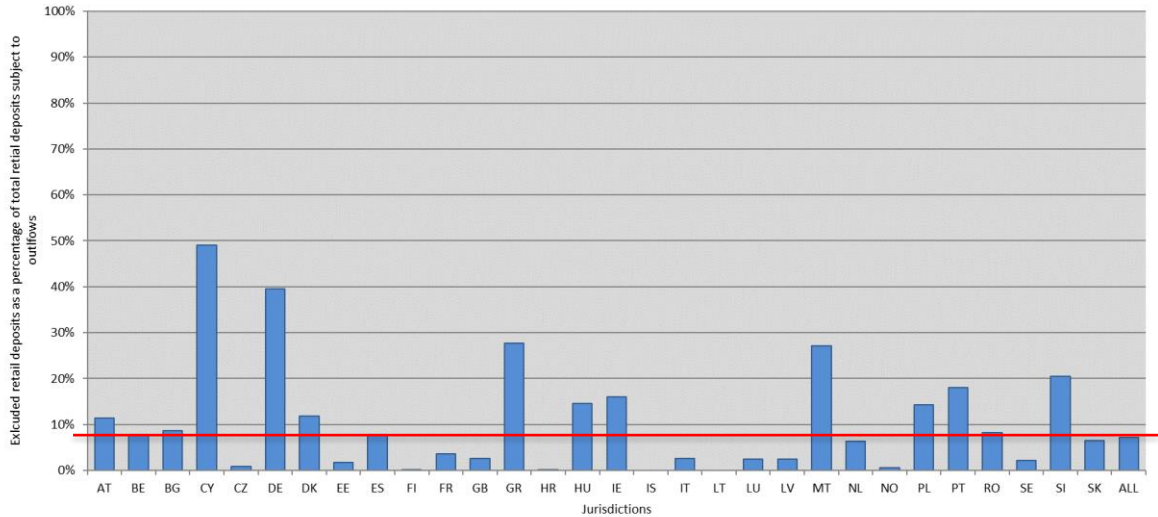
55. Figure 8 and Figure 9 show that, overall, 80% of larger institutions and 70% of smaller institutions report excluded retail deposits below 10% of retail deposits subject to outflows. However, in some cases, these deposits are indeed material. It seems that smaller institutions are more prone to not recognising excluded retail deposits. A larger proportion of smaller institutions (47%) than larger institutions (20%) do not report excluded retail deposits.

Figure 9: Excluded retail deposits — larger institutions versus smaller institutions, as of June 2018



56. Figure 10 provides this information in an aggregated manner, by jurisdiction. Divergent approaches appear to be applied across jurisdictions. In some countries, mainly those with excluded retail deposits of higher values, banks report very different amounts.

Figure 10: Excluded retail deposits by jurisdiction (as a percentage of total retail deposits subject to outflows), as of 30 June 2018



57.As regards business models, custody banks, merchant banks and securities trading houses do not report retail deposits and most of the public development banks do not report retail deposits. Figure 11 and Figure 12 show the reported excluded retail deposits for each of the rest of the business models by bank and on average, respectively.

Figure 11: Excluded retail deposits by bank and business model (as a percentage of total retail deposits subject to outflows), as of 30 June 2018

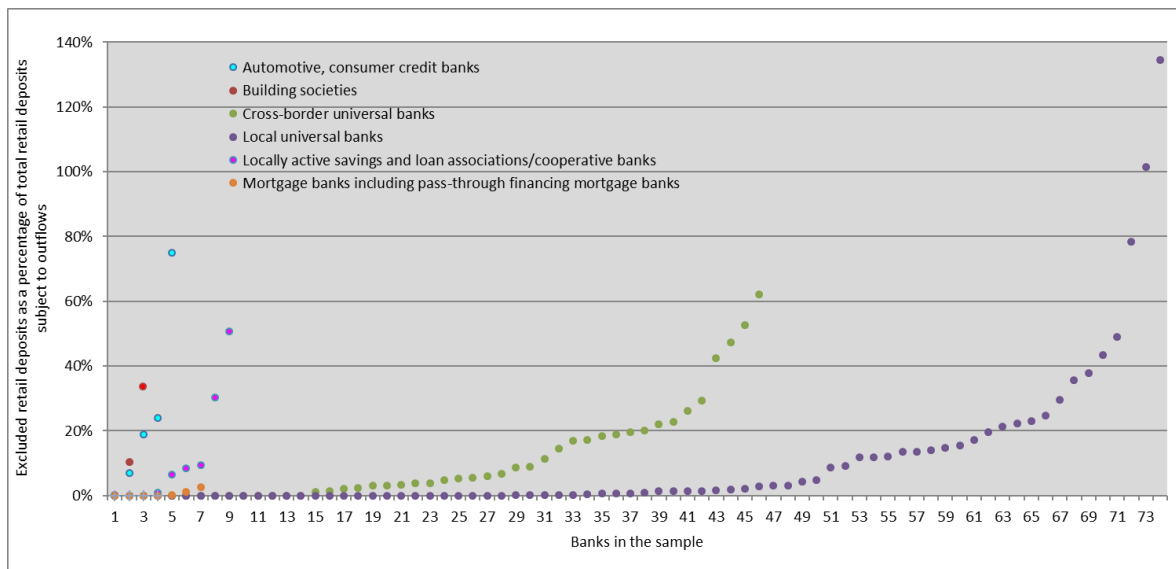
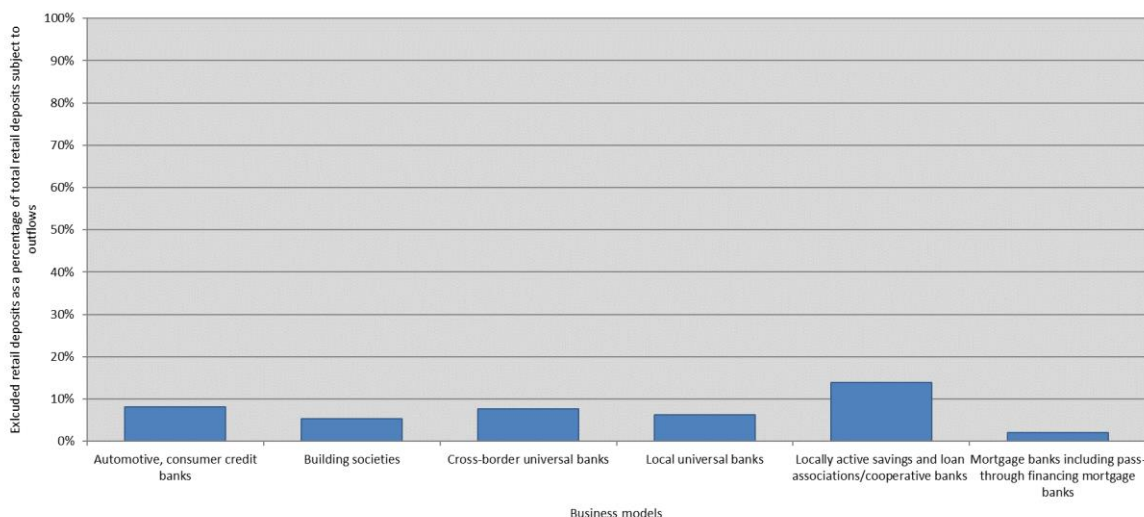


Figure 12: Excluded retail deposits by business model (as a percentage of total retail deposits subject to outflows), as of 30 June 2018



Conclusions

58. Excluding retail deposits from HQLA requirements has a significant impact on the LCR. The LCR Delegated Regulation does not provide a precise definition of material penalty for the application of that exclusion. This has prompted the use of very diverse approaches that are all compliant with the regulation in force, although some appear to be more prudent than others. Some are based on the reasoning that the material penalty that would ensure no withdrawal should exceed the amount of interest paid or accrued at the moment of early withdrawal, whereas others consider that this is not necessary. Therefore, there is a material risk if it is not sufficiently ensured that outflows will not materialise under severe stress. It also jeopardises the level playing field across banks.

59. Against this background, the EBA sees merit in providing some guidance providing a non-exhaustive list of good practices and prudent uses of the notion of material penalty within the limits set out in the LCR Delegated Regulation as a benchmark for banks and supervisors.

2.2.2 EBA guidance on excluded retail deposits from outflows

60. The following aspects constitute the general principles of the EBA guidance, as set out in detail in paragraphs 59 and 60, on a common understanding of the term ‘material penalty’ in the context of Article 25(4)(b) of the LCR Delegated Regulation²⁴:

- a) As a result of the 0% outflow rate to be applied to excluded retail deposits from outflows, there should be a sufficient degree of expectation that there will be no withdrawal within 30 calendar days, including during a period of combined idiosyncratic and market-wide stress scenario, as referred to in Article 5 of the LCR Delegated Regulation.

²⁴ In the case of legal constraints, the exclusion envisaged in Article 25(4)(a) applies directly. No guidance is needed for this case. The EBA guidance does not refer to this case.

- b) The LCR Delegated Regulation seems to assume that this happens when a material penalty has to be paid by the depositor in the event of early withdrawal within 30 calendar days.
- c) In assessing the materiality of the penalty under a prudent approach, the degree of expectation of withdrawal in different situations needs to be assessed.
- d) The approach should also assess the expectation of or proneness to withdrawal on the basis of whether or not the early withdrawal penalty would exceed the interest accrued, making the amount to be withdrawn early either lower or higher than the principal amount of the deposit.
- e) In particular, deposits that can be withdrawn early under stress by an amount equal to the total amount of the principal would necessitate additional factors to the loss of accrued interest to show prudent expectations of no withdrawal. These additional factors do not necessarily have to trigger additional payments to the bank. In this manner, the report also takes into account the existence of some national legislations on the conduct of business and/or consumer protection that limit the amount of the early withdrawal penalty to protect the principal amount. For these cases, this report explains the way that banks under these circumstances are expected to apply Article 25(4) of the LCR Delegated Regulation.
- f) The approach intends to be realistic and prudent simultaneously. It primarily targets a category of retail deposits in the LCR Delegated Regulation in which deposits with terms longer than 30 calendar days are expected to be found. Deposits held in transactional accounts are not expected to have terms longer than 30 calendar days. The same can be applied, in some cases, to deposits that are part of an established relationship. At the same time, the approach intends to be prudent by focusing on the most sticky retail deposits within their expected scope of application, i.e. those subject to 10% outflow rate and the amount of which is fully covered by a DGS.

61. Credit institutions are expected to be able to provide their competent authority, upon request, with a reasoned justification — based on samples (or experiences) consistent with stress scenarios for the purposes of the LCR, as envisaged in Article 5 of the LCR Delegated Regulation — that they do not expect early withdrawals from the deposits excluded from the calculation of outflows in accordance with Article 25(4) of the LCR Delegated Regulation (implicit in the 0% outflow rate to be applied). The categories of retail deposits excluded should be clearly identified ('circumscribed categories' in Article 25(4) of the LCR Delegated Regulation) under this assumption. Therefore, there should be specific reasoned features or historical behaviour in the concrete categories of retail deposit categories in order to benefit from 0% outflows. Indeed, a similar reasoning already exists in Article 24(5) of the LCR Delegated Regulation for assessing whether or not stable retail deposits could benefit from a reduced 3% outflow rate (versus a 5% rate). The need to be able to provide this justification is even more relevant in the case of retail deposits excluded from the calculation of outflows in accordance with Article 25(4) of the LCR Delegated Regulation (i.e. an outflow rate of 0%). This reasoned justification that

credit institutions should be able to provide does not add a requirement but rather further clarifies the framework in which the exemption can be applied in the regulation.

62. In addition, the following non-exhaustive examples, which could serve as a benchmark for the application of Article 25(4) of the LCR Delegated Regulation, are deemed to be prudent practices and to contribute to a common understanding and level playing field across the EU:

- a) The retail deposits envisaged in Article 25(1) of the LCR Delegated Regulation and for which the entire amount is covered by a DGS in accordance with Directive 2014/49/EU or by an equivalent DGS in a third country are those for which it is expected that a reasoned justification can be provided, as referred to in point a). This provides a realistic and prudent approach in practice for deposits with terms longer than 30 days.
- b) A penalty defined as a percentage of interest, in the context of a situation of an evident extremely low interest rate, is not expected to justify the 0% expected withdrawal.
- c) A penalty that would result in the amount of the deposit to be received, in the case of early withdrawal, being materially lower than its principal amount is generally enough to justify the 0% expected withdrawal.
- d) A penalty that would result in the amount of the deposit to be received, in the case of early withdrawal, being equal to or lower (but not materially lower) than its principal amount would necessitate additional factors, such as high opportunity costs (e.g. due to a significant market-wide decrease in interest rates, the interest rate of the early withdrawn deposit is substantially higher than the offered interest rates for similar products for reinvestment, or the possibility that an early withdrawal might make the depositor lose material public subsidies or tax advantages) or other transactional costs (e.g. linked to other products in the bank), to provide justification of the 0% expected withdrawal.
- e) A penalty that would result in the amount of the deposit to be received, in the case of early withdrawal, being greater than its principal amount (and therefore including some interest) would not likely be able to justify the 0% expected withdrawal.

2.3 Recognition of inflows stemming from maturing HQLA

63. This section covers the case of HQLA subject to high haircuts and maturing within 30 days; here it is argued that operational requirements are no longer being met.

64. [Q&A 2013 154](#) recognises that HQLA meeting the general and operational requirements and maturing within 30 calendar days should be computed as HQLA and not as inflows.

65. In particular, Article 32(6) of the LCR Delegated Regulation states that ‘credit institutions shall not take into account any inflows from any of the liquid assets referred to in Title II other than payments due on the assets that are not reflected in the market value of the asset’.

66. In the same vein, paragraph 155 of the Basel LCR standards states that ‘Level 1 and Level 2 securities maturing within 30 days should be included in the stock of liquid assets, provided that they meet all operational and definitional requirements’.

67. This allows the true value of the liquidity available from day 1 in the LCR 30-day window to be better reflected, whereas contractual inflows could be effective later on during the 30-calendar-day period.

68. Cases have been observed in which institutions have reclassified HQLA, subject to high haircuts, as non-HQLA during the 30 calendar days prior to their maturity, with these institutions arguing that some operational requirements are no longer met by those HQLA. These assets are then considered not in the liquidity buffer but as inflows. The inflow rate from maturing securities in the LCR Delegated Regulation is 100% (Article 32(2) of the LCR Delegated Regulation). As a result, the LCR might be materially improved by computing 100% inflows from those assets, despite being subject to the 75% inflow cap with the rest of the inflows, rather than considering them in the buffer subject to high haircuts.

69. For example, a bank might have been holding Level 2B assets with nominal value and market value equal to 100 subject to 50% haircut. The liquidity value of these assets in the buffer would be 50. Assuming that some operational requirement is no longer met and that the residual maturity of these assets is less than 30 calendar days, the assets would stop being eligible as HQLA and would be computed as inflows at 100% inflow rate of the payment due on maturity. Thus, the bank would change from computing HQLA of 50 in the liquidity buffer to 100 as inflows.

70. These practices would be reflected as a decrease in the value of HQLA subject to high haircuts, in reporting template C 72.00 on HQLA, and simultaneously as an increase in the inflows from securities, in reporting template C 74.00 on inflows.

71. Compliance with some operational requirements is not observable in a purely objective manner and needs some judgement. Therefore, institutions are expected, in these cases, to be able to clarify in detail to their competent authority, upon request, why the relevant operational requirements are no longer met and to explain the impact on the LCR. Changes in the

compliance with operational requirements should be well substantiated. The intention of this approach is to avoid the risk of computing higher liquidity resources than those that would indeed be available via a potential liquidation of the relevant HQLA prior to maturity.

2.4 Optionality and contingent inflows

72. The general treatment of inflows and outflows in the LCR, in the context of transactions containing an option exercisable within 30 days, has been assessed. Several Q&As have been raised in the context of various transactions with these characteristics. Against this background, the EBA has worked on an approach to be applied in a consistent manner based on legal and supervisory foundations. This approach is meant to ensure a harmonised implementation of the LCR in the context of these specific transactions:

- Generally, inflows dependent on the exercise of an option are not eligible for the LCR. They should be considered contingent and therefore not contractually concluded²⁵.
- In contrast, outflows dependent on the exercise of an option would depend on the expectations of the option being exercised²⁶. The option is expected to be exercised in a stress scenario and the relevant outflow rate should apply.

73. The EBA has already provided guidance by publishing a number of Q&As in this regard in the context of different transactions:

- Potential inflows from deposits with terms longer than 30 calendar days placed by an institution with an option for early withdrawal: [Q&A 2112](#) clarifies that ‘options that would advance inflows from term deposits to the reporting institution shall be considered contingent and not contractual, hence as not to be exercised. Accordingly, term deposits maturing beyond the 30 day horizon, for which the depositor (being the reporting institution) has the option to withdraw the money within the next 30 days, shall not be considered as inflows in the LCR.’
- Potential inflows from HQLA where an institution has sold call options exercisable during the following 30 calendar days on these HQLA: [Q&A 2542](#) clarifies that ‘In the case of sold call options which are exercisable within 30 calendar days an expected outflow should be considered as the positive difference between the market value of the underlying and the strike price of the option, if the option is expected to be cash settled, or as the positive difference between the liquidity value calculated according to Article 9 of the Commission Delegated Regulation (EU) 2015/61 of the underlying asset and the strike price of the option, if the option is expected to be subject to physical delivery. In case those differences resulted negative (strike price is higher than the liquidity value), no inflow should be considered since it would be contingent and not recognisable in the LCR following Article 32(1) of the Commission Delegated Regulation (EU) 2015/61.’

²⁵ In accordance with Article 32(1) of the LCR Delegated Regulation, inflows may comprise only contractual inflows from exposures that are not past due and for which the institution has no reason to expect non-performance within 30 calendar days.

²⁶ In accordance with Article 22(1) of the LCR Delegated Regulation, liquidity outflows shall be calculated by multiplying the outstanding balances of various categories or types of liabilities and off-balance-sheet commitments by the rates at which they are expected to run off or be drawn down as indicated in Chapter 2 of Title III.

- Derivative contracts allowing a credit institution to sell some of the inventory of pre-specified securities at their market value less a slight discount (the ‘strike’ price): over the life of the transaction, the credit institution pays a running fee to the counterparty and has the right (but not the obligation) to trigger the sale. The underlying instruments are mostly listed equities from main indices that generally qualify as Level 2B assets for the purpose of the LCR. The counterparty is usually not subject to the LCR (e.g. pension fund). Such derivative contracts have similar characteristics as put options but have moving strike prices, essentially resulting in negative pay-outs amounting to the discount (if the option is exercised). Computing potential inflows stemming from the exercise of the cited right to sell the underlying securities is an issue that has been raised in practice in the context of such derivative contracts. EBA Q&A 2112 and EBA Q&A 2542 suggest a general prohibition of considering contingent derivative inflows in the LCR calculation in accordance with the LCR Delegated Regulation. No inflow can be computed until the effective exercise of the option or the right to sell.

74. The general approach developed here, and particularly in the Q&As issued on the matter, is expected to be applied in the context of contingent inflows and outflows. This ensures a consistent and harmonised approach in the identification and quantification of inflows and outflows in the LCR. Otherwise, the level playing field would be materially jeopardised.

2.5 Interbank swaps of retained covered bonds or ABS

75. Paragraphs 1 and 3 of Article 7 of the LCR Delegated Regulation, on general requirements for liquid assets, state:

1. In order to qualify as liquid assets, the assets of a credit institution shall comply with paragraphs 2 to 6.

2....

3. The assets shall not have been issued by the credit institution itself, its parent undertaking, other than a public sector entity that is not a credit institution, its subsidiary or another subsidiary of its parent undertaking or by a securitisation special purpose entity with which the credit institution has close links; ...

76. Banks cannot compute retained own securities as HQLA as per Article 7(3) of the LCR Delegated Regulation. However, cases have been observed in which two banks swap retained own securities (covered bonds and ABS) and recognise the assets received as HQLA.

77. Strictly speaking, the assets received in the swap could be considered HQLA if they meet the requirements laid down in Articles 7 and 8 of the LCR Delegated Regulation, can be classified in any category within Chapter 2 of Title II of the LCR Delegated Regulation and comply with the caps set out in Article 17 of the LCR Delegated Regulation.

78. Policy concerns could be raised about the potential liquidity of these assets regarding their marketability, especially in cases where these assets have been retained since their issuance without having been traded in the market, together with the fact that these assets could exceed recommended concentration thresholds, particularly on mortgage exposures.

79. Institutions are expected to provide the relevant supervisory authority, upon request, with detailed pricing evidence and marketability tests of those assets received (mainly Articles 7(5), 8(2) and 8(4) of the LCR Delegated Regulation contain the relevant general and operational requirements to be met), which are required for them to become LCR HQLA eligible.

80. According to Article 7(5) of the LCR Delegated Regulation, banks have to make sure that the value of assets recognised as liquid assets in the LCR is 'capable of being determined on the basis of widely disseminated and easily available market prices. In the absence of market-based prices, the value of the assets must be capable of being determined on the basis of an easy-to-calculate formula that uses publicly available inputs and is not significantly dependent upon strong assumptions.' The latter condition (in the absence of market-based prices) may be particularly relevant to this case. In this regard, supervisors are expected to verify whether the value of the asset can be determined reliably based on either (i) similar assets of the same issuance programme of the originating institution for which market-based prices are available or (ii) comparable assets for which market-based prices are available that are issued by a different credit institution within the same jurisdiction.

81. As defined under Article 8(2) of the LCR Delegated Regulation: ‘credit institutions shall have ready access to their holdings of liquid assets and be able to monetise them at any time during the 30 calendar day stress period via outright sale or repurchase agreement on generally accepted repurchase markets. A liquid asset shall be deemed readily accessible to a credit institution where there are no legal or practical impediments to the credit institution’s ability to monetise such an asset in a timely fashion’. In this regard, supervisors should verify that the assets obtained through the swap are classified as HQLA only if their monetisation is practically feasible. In particular, the bank should be able to demonstrate that the monetisation of these assets would not impede, or conflict with, the contractual obligations related to the unwind of the swap.

82. Article 8(4) of the LCR Delegated Regulation states that ‘credit institutions shall regularly, and at least once a year, monetise a sufficiently representative sample of their holdings of liquid assets by means of outright sale or simple repurchase agreement on a generally accepted repurchase market.’ It adds that ‘credit institutions shall develop strategies for disposing of samples of liquid assets which are adequate to: (a) test the access to the market for those assets and their usability’. Credit institutions should inform supervisors if they have performed these repurchase agreements or sales tests on a sample of the cited swapped assets received.

2.6 The time dimension of the LCR

83. This section explores transactions improving the LCR at the end of the month for supervision purposes.

84. Policy concerns arise regarding the fact that some institutions might build up stronger liquidity positions towards the reporting date, while still incurring significant outflows within the 30-day period. If the LCR were to be reported on a daily basis, the LCR could be significantly lower than its month-end level. For example, a bank might receive a cash transfer from its parent a few days prior to the reporting date and return the amount at the beginning of the following month.

85. It should be recalled that Article 4(4) of the LCR Delegated Regulation, in conjunction with Article 414 of the CRR, requires that, if the LCR falls or is reasonably expected to fall below 100% at any time, institutions immediately notify the relevant competent authority and submit a plan for the timely restoration of compliance with the LCR. Supervisors might complement their LCR assessment of stressed inflows and outflows with higher granularity by using the maturity ladder of the ITS on ALMM (template C 66.00), which contains daily and weekly granularity to further assess the risks of this practice on a case-by-case basis for different time horizons.

Benefiting from the time dimension of the LCR via risks beyond the 30-day window

86. Some banks might be benefiting from the time dimension of the LCR via risks beyond the 30-day window. For example:

- evergreen ²⁷ '31-day' liabilities contain unwritten/informal arrangements for early withdrawal;
- banks issue a 3-month paper to investors and, at the same time, enter into unwritten understandings that, once the residual maturity for the commercial paper reaches 1 month, the investors will sell back or exchange the security for a new 3-month paper.

87. These practices might allow banks to not compute the relevant outflows in the LCR and not hold the corresponding necessary liquidity buffer. These initiatives generate potential 'cliff' risks with significant potential outflows building up just outside the 30-day horizon. For example, the exercise of such informal arrangements could lead to early withdrawals. There is also a risk that, under stress, investors would not roll the transaction over, leading to a sudden increase in outflows within the 30 days.

88. Credit institutions are advised to develop prudent approaches. Supervisors might have a more detailed picture of the liquidity risk of the banks by using specific survival periods adjusted to these maturity scenarios, namely in scenarios where potential outflows might concentrate, on an institution-specific basis and via stress tests in the context of the Supervisory Review and Evaluation Process. In this regard, the maturity ladder in the ITS on ALMM is a useful tool, as it

²⁷ These are liabilities that are formally renewed on a permanent basis as long as the maturity approaches 30 days and no early withdrawal option is formally contemplated.

contains daily and weekly granularity in the short and medium term to project inflows, outflows and counterbalancing capacity in different time horizons in order to assess the availability of liquidity under stress for the various maturity scenarios referred to above.

2.7 Notification process

89. There are components in the LCR calculation for which the implementation by banks is subject to specific interaction with the competent authority and for which competent authorities need to explain their approach to the EBA via a notification requirement. The EBA is collecting and reviewing these notifications and aims to establish a further harmonised understanding of the provisions on the basis of the information provided. This includes the following articles of the LCR Delegated Regulation:

- Article 23 requires additional liquidity outflows for other products (i.e. products not covered elsewhere in the LCR framework), which, if material, are required to be reported by institutions (Article 23(2)) and notified by the competent authorities to the EBA (Article 23(3)). The frequency of this process is at least annual and the appropriate outflow rates need to be determined by competent authorities.
- Article 33 is related to the (full or partial) waiver of the cap on inflows, which is for the competent authorities to apply, under conditions, and relates to certain specialised credit institutions: Article 33(3) relates to leasing and factoring activities and Article 33(4) relates to auto-loan, automotive consumer credit financing. In accordance with Article 33(5), the competent authorities notify the EBA of the waivers that have been applied, and the EBA publishes and maintains a list of the specialised credit institutions exempted or subject to a higher cap²⁸.
- Articles 29 and 34 require notifications on the preferential treatment of cross-border outflows and inflows within a group or an institutional protection scheme. It is the responsibility of the relevant competent authorities to grant this treatment, which involves giving permission to apply a lower outflow on a case-by-case basis for undrawn credit and liquidity facilities.
- Article 26 is related to outflows with interdependent inflows, authorised by competent authorities and subject to the compliance with specific conditions. Under the amended²⁹ LCR Delegated Regulation, which shall apply from 30 April 2020, there will be an additional notification requirement under which competent authorities shall inform the EBA of the institutions that benefit from the netting of outflows with interdependent inflows under Article 26. The application of this provision may have a material impact on the LCR, significantly reducing the HQLA requirements. The conditions required for its application need to be met in a strict manner and any risk of misuse of this provision should be promptly spotted. Therefore, close monitoring of the use of this provision by the EBA will be key.

²⁸ <http://www.eba.europa.eu/supervisory-convergence/supervisory-disclosure/options-and-national-discretions>

²⁹ https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2018.271.01.0010.01.ENG&toc=OJ:L:2018:271:TOC

2.7.1 EBA guidance on Article 23 of the LCR Delegated Regulation

90. As regards Article 23 of the LCR Delegated Regulation in particular, questions have been raised on how to consistently understand the 10 broad outflow categories mentioned therein. Under this article, institutions need to assess the likelihood and potential volume of liquidity outflows during 30 calendar days for other products and services that are not referred to in Articles 27 to 31 and which they offer or sponsor or which potential purchasers would consider associated with them. Consequently, it is important that both banks and competent authorities are able to identify the relevant products and services.

91. For these reasons, the EBA has developed some guidance for supervisors that provides common definitions of the categories of products and services to be included. For example, it deals with the questions of whether or not certain products should be covered by Articles 27 to 31 and whether or not there should be a distinction between uncommitted and committed products. While the guidance covers the product categories, at this stage, for lack of experience, it does not provide any support on the outflow rates to be determined by the competent authorities.

92. The guidance was primarily developed to clarify how competent authorities should notify the EBA against the backdrop of the common definitions. Competent authorities notify the EBA at least once a year of the outflows assigned regarding material products and services covered by Article 23. Competent authorities will notify the EBA more often than annually in cases in which significant changes would occur in the types of products or services for which they have determined outflows or in the methodology used to determine outflows³⁰. On the basis of the experience to be gained, the EBA will broaden its assessment in the future to also encompass the consistency of outflow rates, where justified.

General considerations for the assessment of Article 23 of the LCR Delegated Regulation

93. This guidance provides a common interpretation of Article 23 of the LCR Delegated Regulation for use by competent authorities to foster consistent application of that article throughout the EU.

94. The starting premises are the following:

- For the purposes of Article 31 of the LCR Delegated Regulation, ‘committed’ means non-cancellable or conditionally cancellable. The term ‘committed’ does not cover offers that have not (yet) been accepted by the counterparty/client.
- For the purposes of Article 31 of the LCR Delegated Regulation, a ‘credit facility’ is a facility committed to extending funds if requested by the client in the future. This does not include (i) derivatives, (ii) guarantees, (iii) liquidity facilities in accordance with Article 31(1) or (iv)

³⁰ Article 23(3) of the LCR Delegated Regulation states: ‘The competent authorities shall at least once a year report to the EBA the types of products or services for which they have determined outflows on the basis of the reports from credit institutions, and shall include in that report an explanation of the methodology applied to determine the outflows.’

a ‘contractual commitment to extend funding’ under Article 32(3)(a) of the LCR Delegated Regulation.

- For the purposes of Article 32(3)(a) of the LCR Delegated Regulation, ‘contractual commitment to extend funding’ means a transaction that is contractually due within the next 30 days, after which the extension would lead to an outflow of liquidity within the following 30 days and thus would reduce inflows of monies due, unless the outflow is captured elsewhere in the standard as a 100% outflow.

95. Accordingly, all uncommitted products are treated under Article 23 of the LCR Delegated Regulation and committed credit facilities are generally treated under Article 31 of the LCR Delegated Regulation. Products belonging to the Article 23 categories³¹ ‘iv) mortgages that have been agreed but not yet drawn down’ and ‘vii) planned outflows related to renewal or extension of new retail or wholesale loans’ normally are committed. In addition, the treatment under Article 23 of guarantees and contingent outflows due to triggers other than downgrade triggers can relate to committed products.

96. On the basis of these starting premises, as well as the understanding that specific products or services already captured in Articles 27 to 31 of the LCR Delegated Regulation cannot be considered for the purposes of Article 23 of the LCR Delegated Regulation, a (non-exhaustive) list of products or services for which a treatment under Article 23 would be warranted is provided below.

List of products or services to be reported under Article 23 of the LCR Delegated Regulation

97. The list of products or services below represents a common understanding of what would fit under the different categories of Article 23 of the LCR Delegated Regulation. The list of products follows the categorisation of the notification template used by competent authorities for notifying the EBA and does not necessarily follow the order of the rows in the COREP template³². This notification template includes, among other columns, an outflow rate column and a column for explanation on the methodology.

(i) Uncommitted funding facilities

98. In this category, the following should be reported:

- uncommitted credit facilities;
- uncommitted funding facilities that may arise from underwriting activities (i.e. activities to originate debt or equity).

³¹ See the next section for the list of products and services.

³² In COREP, rows 720 to 870 of template C 72.00 relate to Article 23 of the LCR Delegated Regulation.

99. It must be noted that guarantees other than trade finance related off balance sheet products should be notified under category (x) instead of category (i).

100. It must also be noted that contingent outflows due to triggers other than the downgrade triggers referred to in Article 30(2) of the LCR Delegated Regulation should be notified under category (x) instead of category (i).

(ii) Undrawn loans to wholesale counterparties

101. The products or services falling under this category should be exceptional, since most of them would qualify as credit or liquidity facilities under Article 31 of the LCR Delegated Regulation.

102. Among those exceptional cases, the following items could be mentioned:

- ‘Flagship projects’, which can be described as exceptional cases of loans that are high in volume and whose amount is likely to be delivered within the next 30 calendar days but is not contractually fixed, especially when the treasury function has already taken into account outflows for such a project. Often they have a high level of management attention and are objects of prestige such as financing for an airport, nuclear power plants, opera houses, etc.
- Construction-related loans — which are contractually not yet fixed — which may be drawn down within or beyond the 30-day horizon.

(iii) Advances to wholesale counterparties

103. The products or services falling under this category should be exceptional, since most of them would qualify as credit or liquidity facilities under Article 31 of the LCR Delegated Regulation. Only undrawn advances should be included.

(iv) Mortgage loans that have been agreed but not yet drawn down

104. The products or services falling under this category should be exceptional, since most of them would qualify as credit or liquidity facilities under Article 31 of the LCR Delegated Regulation.

105. Among those exceptional cases, the following items could be mentioned:

- Pipeline mortgages, which are the aggregate of formally agreed advances, including amounts recommended for retention, all instalment elements and further advances. As a background, agreed mortgage loans, even when they have been accepted, do not necessarily result in actual outflows in the following 30 days. After a loan has been agreed, the borrower will typically withdraw the monies lent by the bank within a couple of weeks or sometimes months, which means that not 100% of the amount of the agreed mortgage loans will lead to an outflow within 30 days. If the competent authority notifies the EBA of

pipeline mortgages in category (iv), it will need to explain in the comment column why a treatment elsewhere under the LCR framework would not be appropriate for the items notified.

- If mortgage loans have not yet been accepted by the prospective borrower, they should be reported under category (x) (see below). The degree to which the mortgages are accepted or not by the prospective borrower should be clarified as much as possible.

(v) Credit cards

106. This category includes only uncommitted credit cards that are settled at regular intervals (mostly monthly) and does not include services provided through debit cards. This category should, in particular, include credit cards that:

- may be cancelled unconditionally at any time without notice;
- are unadvised (i.e. not known to the client but prepared for by the bank).

(vi) Overdrafts

107. This category comprises all uncommitted overdraft facilities that may be allowed by a credit institution on an account but that the customer has not applied for.

108. It must be noted that committed overdraft facilities (as they are credit facilities) are already captured in Article 31 of the Delegated Regulation and cannot be captured in category (vi).

(vii) Planned outflows related to the renewal or extension of new retail or wholesale loans

109. This category comprises those extensions exceeding 100% of the maturing amount.

110. It must be noted that a product within this category can be uncommitted if there is no contractual commitments to the customer(s) to extend funding but there is an expectation that the customer will ask for an extension.

111. Forward starting transactions do not fall into this category.

(viii) Trade finance off-balance sheet related products

112. Competent authorities may apply up to a 5% outflow rate in accordance with Article 23(2) of the LCR Delegated Regulation.

113. It will need to be clarified what type of trade finance related off-balance-sheet product it is. In particular, this includes the following items in Annex I of the CRR:

Point 2(a): 'trade finance off-balance sheet items, namely documentary credits issued or confirmed'.

Point 3(a): 'trade finance off-balance sheet items:

- (i) documentary credits in which underlying shipment acts as collateral and other self-liquidating transactions;
- (ii) warranties (including tender and performance bonds and associated advance payment and retention guarantees) and guarantees not having the character of credit substitutes;
- (iii) irrevocable standby letters of credit not having the character of credit substitutes'.

(ix) Planned derivative payables

114. The products or services falling under this category should be exceptional, as derivative-related outflows would normally be captured under Articles 21 and 30 of the LCR Delegated Regulation.

(x) Other

115. This residual category includes the following, among other items:

- Guarantees other than trade finance related off-balance-sheet products, which should be included under a category entitled '(x) Guarantees other than trade finance related off balance sheet products'.
- Contingent outflows due to triggers other than the downgrade triggers referred to in Article 30(2) of the of the LCR Delegated Regulation, which should be named '(x) Contingent outflows due to triggers other than the downgrade triggers referred to in Article 30(2) of the Delegated Regulation'.
- Mortgage loans that have been offered but have not been accepted yet by the borrower. These should be included under a category entitled '(x) Mortgage loans offered but not yet accepted'. This would typically represent the situation in which a loan offer is made to a borrower and it is not yet certain that the borrower will accept the offer. The estimation of the likelihood of these outflows and other relevant aspects should be clarified as much as possible.

116. It will need to be clarified why the product or service being categorised here would fit under Article 23 of the LCR Delegated Regulation and why it would not fit within categories (i) to (ix).



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