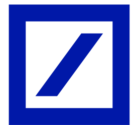
Deutsche Bank



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Dear Mr. Farkas

DB's response to the European Banking Authority's consultation on draft RTS on additional liquidity outflows (EBA/CP/2013/19).

Deutsche Bank (DB) welcomes the opportunity to respond to the EBA's consultation paper (CP) on additional liquidity outflows.

Our response consists of some general comments followed by responses to the specific questions in the consultation. As always, we are happy to discuss any of the points raised in our response.

Yours sincerely,

Andrew Procter
Global Head of Government and
Regulatory Affairs

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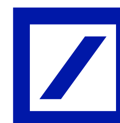


General comments:

Recognition of Internal Models

We strongly welcome the recognition given by the EBA to internal model based calculations for additional collateral outflows within the remit of this ITS.

Derivatives are a substantial part of DB's business and we have therefore developed sophisticated models for calculating potential liquidity outflows on these transactions in adverse market conditions. The validity of the 'Expected Positive Exposure' (EPE) model, as a suitable means for calculating outflows associated with transactions of this nature, is essential for arriving at a truly representative liquidity outflow for the risk that this regulation aims to capture.

Given the inherent complexity and interconnectedness of derivative products we strongly believe that for larger institutions like DB, it would not be possible to calculate the outflow on a standardised or simplified basis. We do however question the rationale of limiting the application of the internal model approach only to those institutions *currently* using a previously approved model for all activities and entities.

Should for instance a new legal entity be acquired in the future, or where a bank is currently integrating a new entity, the existing internal model may not necessarily capture the transactions in that entity. Precluding the institution from using the advanced model would not make any sense in this scenario as the entity would, in time, be integrated within the risk management practice of the group. We therefore ask the EBA to give further consideration to the necessity of the restrictive nature of this reference within the ITS. Particularly as these restrictions appear to disincentive the use of sophisticated internal modelling for liquidity outflows, an approach which is contrary to the aims of most recent regulatory reforms.

As an alternative we suggest that, for the consolidated LCR return, a mixed-approach should be permissible for the calculation of the outflow. For instance:

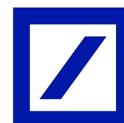
A group comprised of the following entities.

Entity	Total Assets	Model Used (legal entity)	Outflow calculated on a legal entity basis
A	500bn	Internal	5bn
B	400bn	Internal	3bn
C	30bn	Standardised	0.05bn
Total Group	930bn	Mix	8.05bn

Entity C represents less than 5% of the total assets of the group, and as such, any potential derivatives exposure is likely to be immaterial. Instead the calculation of outflows related to this entity should be a simple addition of the standardised number to the internal model outflow for the other two entities. This approach does not represent "cherry picking" and is likely to ultimately lead to much more conservative outcomes.

Materiality of adjustments required in accordance with Article 6

Although we welcome the recognition of the internal model approach, it is important that the EBA give consideration to the fact that such models are calibrated to be specific to the institution using them. Furthermore, models such as EPE were originally specified for credit risk assessment purposes, not to calculate a particularly defined liquidity flow.



Therefore, we believe that the prescribed adjustments that the EBA has stipulated in this ITS are, in some cases, overly burdensome due to the impact on the output from an existing model. Where a model does not currently capture 100% of all derivative and secured financing transactions for instance, yet does capture those which are truly material, this deficiency should not preclude the model's use.

Even without these adjustments, we believe the internal model approach remains the most robust mechanism for calculating this outflow in accordance with both the language of the CRR, and the liquidity risk the regulation aims to capture. In particular, the following adjustments may be so immaterial in nature, we question their necessity:

1. **The capture of minimum transfer amounts (MTA) (Article 6.1(b)(i)):** Transfer amounts are normally very small in value and are designed expressly to preclude a large number of collateral calls for immaterial amounts. As they apply bilaterally, during normal course of business the MTA would not be expected to have a net impact on the overall collateral position. For these reasons, MTAs are currently not accounted for in our EPE model. It would require a substantial adjustment to our model to incorporate these small amounts and, given the immateriality of the impact (i.e. an outflow of this size will not decrease the LCR ratio), we question the necessity for the adjustment

2. **Secured Financing Transactions expiring outside of the 30 days:** There are very few secured financing transactions where a change in the value of the transaction might lead to a collateral outflow or inflow. It is highly plausible that this only covers collateral swap activities, where the value of either the collateral posted or received moves in an asymmetrical fashion in relation to the value of the swapped collateral. For instance, major index equities are swapped for high quality government bonds. The value of the equities remains stable, whilst the government bonds increase in value and so you need to post more of the lower quality collateral to your counterparty. In this scenario, it is important to note that the LCR standard already accounts for those swaps expiring within 30 days through the weighting attributed.

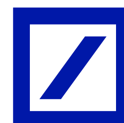
For each of the above points, we suggest that the EBA implements a materiality threshold for the adjustments. We ask the EBA to take into account our recommendation that any adjustment which relates to transactions <5% of outstanding notional would be overly burdensome and should not be required as it would not significantly increase LCR outflows.

Materiality of "other contracts of a similar nature"

Annex II of the CRR, for which the whole population of products must be covered by the internal model in order to be eligible, includes point 2(e) "other contracts of a similar nature". Institutions should be permitted to make use of the internal model if most of the transactions are included within the scope of the simulation and are able to demonstrate that the residual transactions are immaterial.

For these immaterial positions, as is the case with the legal entity consolidation, the use of the standardised methodology should be permitted.

Lead-time for model adjustments



With regard to timing, sufficient transitional arrangement should be put in place to allow banks to adapt their models. We suggest a minimum timescale of two years to make the necessary IT adjustments to capture all transactions. In the meantime, we ask that the EBA considers putting in place transitional provisions for the recognition of approved internal models for those banks currently using them, prior to the necessary adjustments.

A-symmetrical treatment of collateral swap transactions

The calculation of outflows relating to transactions whereby the value of the collateral has moved (that is, in Accordance with Article 411.1), and those where the transaction requires additional collateral (that is, what this technical standard aims to achieve), may be detached so far as the LCR is concerned, but in reality the two are linked. For instance, a bank will reverse in collateral which it will subsequently use to post as margin. Under Global Master Repurchase Agreements and Global Master Securities Lending Agreements, reverse repos are subject to daily margining. Hence to give no recognition to the change in value of collateral as an inflow on the reverse repo, but expect additional margin to be posted on the derivative, is disconnected and inappropriately penalises banks for carrying out such transactions.

It is important to note that, the change in value of collateral posted is already captured within the 20% outflow line in Article 411(1), with no corresponding recognition for inflows due to market valuation of collateral received. Where a security which is reversed in has changed in value, and margin is posted as security, we cannot recognise the inflow from the change in value but have to account for an outflow, leading to an asymmetrical treatment.