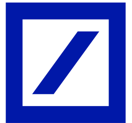
Deutsche Bank



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DB response to the consultation on draft Implementing Technical Standards (ITS) amending ITS on supervisory reporting on Liquidity Coverage Ratio (EBA/CP/2014/45)

Dear Mr. Farkas,

Deutsche Bank (DB) welcomes the opportunity to comment on the European Banking Authority's (EBA) consultation paper on its draft ITS amending the Commission's Implementing Regulation on supervisory reporting with regard to the Liquidity Coverage Ratio (LCR).

In DB's view there are four essential themes which should be taken into account when finalising these draft implementing standards:

1. **Treatment of FX flows**: DB fully agrees that regulators need to monitor a bank's liquidity risk profile in certain material currencies. However, if strict thresholds on a LCR by currency are applied (e.g. 80-100%), the treatment of FX flows as proposed within the draft text would make a LCR by currency extremely punitive. As an alternative approach, DB would like to propose that gross positions be reported as memorandum items to the single currency reports and that netting of flows for liquid currency pairs be permitted for the purposes of the LCR calculation.
2. **Consistency with Basel standards**: The EBA takes a different route from the Basel Committee (BCBS) on the treatment of repos / reverse repos with HQLA collateral and the treatment of forward starting transactions. We urge the EBA to apply the BCBS standards, which will enhance regulatory harmonisation through aligning European and Global approaches.
3. **Treatment of forward starting transactions**: the instructions given relating to forward instruments may result in double counting. DB assumes this to be an unintended consequence which could be clarified in the instructions.
4. **Time frame**: the proposed first reference date – the earlier of December 2015 or six months after the adoption date – puts both supervisors and banks in a difficult position. In order to provide as much clarity as possible, we would appreciate the EBA finding a way to minimise the gap between the reference date and the adoption date.

More detailed comments are provided in Annex I and Annex II. Please do not hesitate to let us know if you have questions or wish to discuss these issues further.

Yours sincerely,

Daniel Trinder
Global Head of Regulatory Policy

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Management Board: Jürgen Fitschen (Co-Chairman), Anshuman Jain (Co-Chairman), Stefan Krause, Stephan Leithner, Stuart Lewis, Rainer Neske, Henry Ritchotte, Christian Sewing
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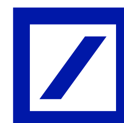


<u>Annex I – Overarching Comments</u>

Treatment of FX Flows

We appreciate that regulators need to monitor a bank's liquidity risk profile in certain material currencies. If strict thresholds on a LCR by currency are applied however (e.g. 80-100%), the treatment of FX flows as proposed within the consultation paper (CP) would make a LCR by currency extremely punitive. To meet the ratio banks would be left with no choice but to minimise the volume of cross currency transactions, in turn limiting banks' ability to offer these products to clients.

The clarifying example for the treatment of FX flows, in section 5.2 of the CP, underlines our view. The treatment illustrated in the example is potentially damaging for banks which are large FX market markers and we urge the EBA to reconsider its interpretation of Article 21 of the Delegated Act.

For a LCR by currency calculation, the treatment of FX derivatives on a single currency basis leads to extremely punitive outcomes. Coupled with the application of an LCR by currency, as now permitted for within the final Delegated Act (DA), this could have material unintended implications for the FX market.

For example: if a bank swaps EUR 100 for USD 150, maturing within 30 days, a USD LCR by currency will show a USD 150 outflow and no corresponding inflow. This treatment assumes within the LCR stress scenario, that the FX markets close in full for 30 days. We consider this a very unlikely scenario given that even during the 2008 crisis, FX markets remained fully operational. The most disruption to these markets was heightened friction leading to the widest USD/EUR spread being observed during 2008 at 2%.

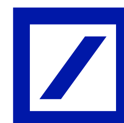
Furthermore, it is DB's view that this treatment was not the intention of the BCBS, or the European Commission, when developing the LCR calculation. This was focused on an all currency combined metric. DB therefore questions whether it was the EBA's true intention to further develop this regulatory approach via the mechanism used within this CP. DB acknowledges that supervisors would want to monitor currency mismatches. DB therefore would like to suggest an alternative approach.

DB proposal on treatment of FX Flows
We consider that the optimal arrangement for FX flows would be that gross positions be reported as memorandum items to the single currency reports whilst the netting of flows for liquid currency pairs be permitted for the purposes of the LCR calculation. This approach strikes a balance between the necessity for supervisors to monitor cross-currency liquidity risk, and minimizes the potentially severe impact upon banks of requiring additional liquidity be held against mismatches in liquid currencies.

However, another option that would provide some relief would be waiving the cap on inflows for FX flows, which would assist somewhat in mitigating the LCR impact where there are significant inflows in a material currency.

In addition, further guidance would be much appreciated with regards to the reporting of derivative transactions and related collateral, specifically on a significant currency reporting basis. As per Article 21 of the DA, derivatives can be reported on a net basis by counterparty subject to the existence of bilateral netting agreements. This means that derivatives can be reported net of collateral to be received if the collateral qualifies as a liquid asset under Title II. In a derivative transaction we could envisage a scenario where one leg is in currency X, the other in currency Y and the collateral received in currency Z (and assuming it meets the Title II requirements).

As per the reporting instructions, in this example the cash-flows on the derivative would be reported as if there was no collateral present (i.e. each leg on a gross basis) and the collateral



would be reported against potentially no derivative transaction with a given counterpart. We would appreciate the EBA confirming that this is indeed in line with the expected reporting requirements?

Treatment of repos / reverse repos with HQLA collateral

The examples given on pages 19 and 20 of the CP highlight the asymmetrical treatment of repo outflows and reverse repo inflows proposed by the EBA. The EBA's approach differs from that set out by the BCBS where both the inflow and outflow are based on the cash amount multiplied by the appropriate HQLA haircut. The EBA should adopt the approach taken by the BCBS to support a global level playing field and to prevent unnecessarily disadvantaging European banks.

Treatment of forward starting transactions

There are two areas of concern on the treatment of forward starting transactions. First, the instructions given relating to forward instruments may result in double counting. The Draft Annex XXV Part 1: Liquid Assets instructions state that HQLAs should be included in template C72.00 where they are in stock at the reference date, 'even if they are sold or used in secured forward transactions'. Furthermore, in Part 3: Inflows instructions state that inflows should be reported from 'transactions which have been contractually agreed but not yet settled at the reporting date'. Consequently, when an institution has entered into a forward sale which has been agreed but is not yet settled, the combined implementation of the above would result in the asset and the inflow being reported. DB does not consider this to be the EBA's intention and recommends that this is clarified in the instructions.

Second, we are concerned that the EBA's treatment of forward starting trades diverges from the approach endorsed by the BCBS (BCBS 284 April 2014) which states that these trades do not need to be factored into LCR calculations. The EBA's approach, which requires the separate reporting of the inflows and outflows, does not reflect the liquidity risk of these trades. This is notably the case where forward starting trades are used to roll existing deposits and where the 75% inflow cap is being applied. The renewal of the trade reduces the Bank's liquidity risk; whilst the separate reporting of the inflow and outflow results in a 25% requirement due to application of the inflow cap. We would recommend the EBA adopt the BCBS's approach. This approach more accurately reflects the liquidity risk arising and enhances regulatory harmonisation through aligning European and Global approaches.

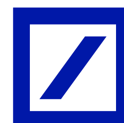
Timeline

The proposed first reference date – the earlier of December 2015 or six months after the adoption date - is out of line with the introduction of the LCR as a minimum regulatory standard in Europe. This adds additional and unnecessary complexity for authorities in monitoring compliance to the ratio in this period, and for firms in making the reports.

We would like to see greater clarity on how regulators will monitor compliance to the revised LCR during the period from 1 October 2015 to the first reference date and urge the EBA to lead a coordinated approach across competent authorities in member jurisdictions to ensure consistency in reporting during this period.

Number of memorandum items

The draft templates include a large number of memorandum items which add to the reporting burden of banks and are not necessary for the calculation of the LCR. Whilst acknowledging that these items may be of interest to supervisors, the benefits of collating this information outweigh the costs of sourcing this information and request that the EBA closely review the memorandum items in light of a cost/benefit analysis.



Single Rulebook Q&As

The EBA notes that some of the changes to the templates are reflective of published answers to the Single Rulebook Q&As. It would be helpful if the EBA could clarify in the instructions where the Q&A responses have been taken into account and the status of the Q&A responses yet to be incorporated at this time.

Points relating to the Delegated Act

We would welcome the EBA taking into consideration the two points below in their communication to the European Commission. Whilst these points relate to the DA rather than the ITS specifically, we believe that they are relevant to this topic and that there would be great value in these points being discussed and solution incorporated into the final frameworks.

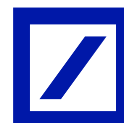
Outflows from other retail deposits (Article 25)

The methodology for determining the application of higher outflow rates for retail deposits overly complex. The initial assessment of a deposit based on multiple conditions is operationally onerous, particularly given the different weightings applied to the criteria (the deposit balance as per Article 25 2(a) is more highly weighted than the other criteria). Furthermore, including criteria such as the deposit balance and expiry date suggest continuous monitoring will be required which places a significant monitoring burden upon firms.

Given the comments above, we would appreciate guidance from the EBA on the expected frequency of review of deposits against the criteria set out in Article 25 (2) of the Delegated Act.

Additional liquidity outflows (Article 30(3))

The EBA's RTS on additional liquidity outflows (EBA/RTS/2014/05) requires firms to use a Historical Look Back Approach ('HLBA') as a floor in the calculation of outflows arising on derivative transactions under an adverse market scenario. However, the approach set out in the EBA paper is somewhat ambiguous, leaving scope for varying interpretations, and differs from the approach set out by the BCBS [BCBS 238] potentially penalising European firms. We would appreciate it if the EBA could provide further guidance on the calculation of the HLBA floor and if the EBA to consider simplifying the template so that banks are only required to disclose the higher of the outflows as determined by the HLBA and AMAO approaches.



Annex II – Responses to the Consultation Paper Questions

Question 1:
The EBA deems it appropriate to keep the remittance dates unchanged in a steady state regime. While the content of the templates is changed, the objective of the supervisory reporting keeps unchanged and the present ITS constitutes only an update of the current existing reporting requirements for the LCR. This means that, once the current ITS is adopted, and after a transition phase, credit institutions would have to remit the monthly reports on each following 15th calendar day as this will be the case starting 1 January 2015 under the existing ITS on reporting the LCR. Nevertheless, the EBA deems it appropriate to introduce longer remittance dates for the first reference dates during the first months, to be limited to a period of six months. Do respondents have arguments to put forward a change on these aspects?

Answer: No specific comments.

Question 2:
Do respondents agree with longer remittance dates for the first reference dates for the new templates for the first six months?

Answer: A 30 day remittance period for the six months post implementation would provide additional time for verifying the data to be submitted.

Questions 3:
Do respondents agree with the implementation period suggested?

Answer: Due to time and operational restraints for both the EBA and firms, it would not be feasible to implement the revised templates before December 2015. Therefore, additional guidance is necessary on how compliance to the LCR will be monitored between 1 October 2015 and the proposed first reference date. Should competent authorities require additional reporting during this period we would appreciate that notice be given as soon as possible and that a consistent approach is taken across member states.

Question 4:
Do respondents agree to the structure and content of the proposed new LCR templates added for credit institutions? Particularly comments from respondents on specific rows, columns or any other item would be very valuable and appreciated including comments on the treatment of secured transactions.

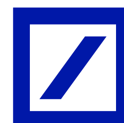
Answer: We appreciate the work the EBA has undertaken to improve the structure and content of the LCR templates. Additional suggestions for further clarifications on specific reporting lines are included in ***Appendix 1***.

Question 5:
Do respondents find the new LCR instructions for credit institutions clear? Particularly comments from respondents on specific rows, columns or any other item would be very valuable and appreciated.

Answer: Comments on the reporting instructions are included in ***Appendix 2.***

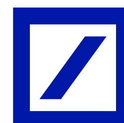
Question 6:
Do respondents consider that the "LCR calculation tool" appropriately translates the use of the different templates for informative purposes?

Answer: No specific comments.



Appendix 1

ROW	ITEM	COMMENT
C72.00 Liquidity Coverage – Liquid Assets		
Row 370	**'Corporate debt securities – non-interest bearing assets held by credit institutions for religious reasons'**	It would be helpful if the EBA could provide a list of corporate debt securities which are eligible for inclusion in this row.
Row 530 / 540	**'Adjustments made to assets due to net liquidity outflows from early close-out of hedges' and 'Adjustments made to assets due to net liquidity inflows from early close-out of hedges'**	For ease of data collection, liquid assets should be reported gross of cash inflows and outflows resulting from the early close-out of hedges and that the total net cash inflow or outflow be reported as an additional reporting line. This would reduce the complexity of the report and remove the need to include these items in the memorandum section.
C74.00 Liquidity Coverage – Inflows		
Row 120	**'Monies due from financial customers being classified as operational deposits where the credit institution is able to establish a corresponding symmetrical inflow rate'**	Guidance from the EBA on how institutions should go about determining the classification of deposits placed with another institution by that institution and how the EBA would expect institutions to evidence the classification would be much appreciated.
Rows 380-400	**'Margin loans: collateral is non-liquid; 'Collateral is non-liquid equity' and 'All other non-liquid collateral'**	Guidance from the EBA on how to quantify non-liquidity: whether this assessment should be made against internal criteria or an external benchmark would be appreciated. In the case of the latter, additional guidance is required. In regards to row 380, DB is of the view that margin loans should always have liquid collateral. It would be helpful if the EBA could provide an example of a transaction which would involve the population of this row.



Appendix 2

ROW	ITEM	COMMENT
C73.00 Liquidity Coverage – Outflows		
Row 630	**'Liquidity facilities to purchase assets other than securities from non-financial customers'**	Please provide greater clarity on what would be included in this row. The instructions state that institutions should report the maximum amount of undrawn committed liquidity facilities 'to the extent that the amount to be reported exceeds the amount of assets currently purchased and where the maximum amount that can be drawn is contractually limited to the amount of assets currently purchased'. Please clarify in what instances an amount greater than zero could arise.
Row 720	**'Other products and services'**	The wording in the instructions is incomplete. Please could this be clarified.
C75.00 Liquidity Coverage – Collateral Swaps		
Rows 740	**'Total collateral swaps (all counterparties) where borrowed collateral has been used to cover short positions**	We would welcome additional guidance and/or examples on the reporting of collateral swaps used to cover short positions.