eba European Banking Authority

MONITORING OF LIQUIDITY COVERAGE RATIO AND NET STABLE FUNDING RATIO IN THE EU

FOURTH REPORT

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1. Executive summary

1.1 Background

1. The monitoring of the practical implementation of the liquidity coverage rate (LCR) and net stable funding ratio (NSFR) is framed within 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.

2. This update to the previous EBA reports on the LCR and NSFR implementation has been rendered necessary by the banking turmoil experienced in March 2023,[1] which highlighted the increased need for enhanced supervision of various liquidity aspects resulting from the change in interest rate environment and related trends in deposit behaviour and concentrations.

3. In light of these events, the EBA aims to keep up to date its previous guidance to banks and supervisors to ensure liquidity risks on main deposit categories (operational and exempted retail deposits) are effectively managed and mitigated. Additionally, this update provides further clarification to the industry on the treatment of open reverse repos, addressing several requests from market participants for more detailed guidance on the LCR calculation related to this matter.

4. In this context, this report complements the three previous monitoring reports on the implementation of the LCR and NSFR, published in July 2019,[2] March 2021[3] and June 2023[4] aiming at fostering 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 and providing guidance to supervisors and institutions on certain areas like outflows applied to certain categories of deposits.

5. The report builds on the same broad methodology and EBA sample of banks. In particular, analyses builds on COREP data, covering an extensive sample composed of all EU banks for which the data is available at the EBA, and qualitative inputs provided by competent authorities. The policy guidance included in this report is not formally legally binding although the EBA expects that banks and competent authorities will follow it. It constitutes

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[1] Basel Committee on Banking Supervision – Report on the 2023 banking turmoil (available here).

[2] Monitoring of liquidity coverage ratio implementation in the EU – First report (available here).

[3] Monitoring of liquidity coverage ratio implementation in the EU – Second report (available here).

[4] Monitoring of liquidity coverage ratio and net stable funding ratio implementation in the EU – Third report (available here).

best practices to follow and focuses on aspects where diverse approaches have been observed in practice with a potential material impact.

6. In addition, this report, provides a specific addendum to the report that the EBA published on 24 July 2023, on interdependent assets and liabilities in the NSFR under article 428f(3) of the CRR (EBA/REP/2023/24). This builds on the EBA mandate in Article 428f(3) of Regulation (EU) No 575/2013 (hereinafter, CRR), to report to the Commission regarding the monitoring of the assets and liabilities treated as interdependent and the adequacy of the list of products and services in paragraph 2 of the same article.

7. The report includes the assessment of the following topics for which guidance to banks and supervisors as well as messages to other market participants are provided:

   i. In Section 2, in the context of Q&A 2024_7053,[5] EBA provides guidance to support the evaluation of the demonstration by banks of the maturity of the open reverse repos within the following 30 days.

   ii. Sections 3 and 4 assess the effects of past guidance – as provided in EBA's first report; and provide further guidance for the identification of operational, excess operational and retail deposits excluded from outflows.

   iii. Section 5 provides the addendum to EBA Report on interdependent assets and liabilities in NSFR under article 428f(3) of the CRR.

1.2 EBA's main observations and conclusions

8. The EBA performed its work on monitoring the LCR implementation on a number of topics that have arisen for discussion, in some cases, or have raised the need to issue specific guidance, in others. Ultimately the target is to contribute to a common understanding of the Regulation in place and to ensure that banking practices do not alter the effectiveness of the regulations nor trigger level playing field issues.

1.2.1 Final stance on inflows from open reverse repos

9. This report provides the guidance to support the evaluation of the demonstration by banks of the maturity of the open reverse repos within the 30-day LCR time horizon. The report argues that for the recognition of inflows from open reverse repos in the LCR, supervisors should take into account if one of the two approaches developed in Section 2 is applied. The first approach considers how inflows can be computed in the LCR after a specific event is triggered, provided that the bank has in place a liquidity risk management policy that specifies that the occurrence of the event shall trigger the call of the option of the open maturity reverse repo in a specific maximum period of time. The second one is built on the

[5] Q&A 2024 7053 on LCR treatment of open maturity reverse repos which can be terminated at any point in time (available here).

historical experience that the bank does not roll over open reverse repos to demonstrate reasonable expectation of exercising the call.

10. The report clarifies that the guidance provided applies only to open reverse repos. Furthermore, it is also clarified that in those cases where inflows were recognised from open reverse repos without the bank terminating these transactions, the LCR calculation should be rectified without inflows being recognised.

1.2.2 Operational deposits and excess operational deposits

11. The report reviews the application of the guidance to identify excess operational deposits included in the first report. Data show that the amount of operational deposits does not fluctuate much from June 2021 to December 2023 when looking at the entire EBA sample. However, some institutions are found having an increase in the amount of operational deposits and/or a decrease in the amount of the excess operational deposits, affecting so their LCR and NSFR levels.

12. Competent authorities informed that the development of operational deposits is analysed on a regular basis within the Liquidity-SREP and also within the top-down liquidity stress tests which are conducted on a yearly basis. Alternatively, some competent authority includes this topic into their ILAAP/ICAAP investigations. However, it was noted also that many competent authorities have not yet undertaken a systematic approach to ensure that the EBA guidance was actually followed by institutions under their remit.

13. Following these findings, to further promote a level-playing field, guidance is provided beyond that already reflected in the first EBA report, regarding the identification of deposit accounts that may generally qualify as operational and characteristics of the trade cycle to take into account in the determination of excess operational deposits.

1.2.3 Retail deposits excluded from outflows

14. This report also reviews the application of the guidance for the identification of a material early withdrawable penalty in the case of retail deposits beyond 30 days. Data shows that almost half of the institutions in the EBA sample experienced an increase in the reported value of exempted deposits.

15. Competent authorities mentioned that the application of the EBA guidance on exempted retail deposits is checked via onsite inspections, deep dives, horizontal analysis, ICAAP or SREP, outlier test and on a case-by-case basis where needed. Some competent authorities claimed that there is no specific supervisory practice in place to check that the guidance is applied.

16. Based on the experience gained, some guidance on the implementation of a material penalty is provided, which will complement the guidance already provided in EBA's 2019 report.

1.2.4 Addendum to the EBA's 2023 policy recommendations to the Commission regarding interdependent assets and liabilities in the NSFR

17. Article 428f(3) of Regulation (EU) No 575/2013 (hereinafter, CRR) mandates the European Banking Authority (EBA) to monitor the assets and liabilities treated as interdependent and to determine whether the criteria required in paragraph 1 of the same Article are met. The EBA shall report to the Commission on the results of that monitoring and shall advise the Commission on whether an amendment to the conditions set out in paragraph 1 or an amendment to the list of products and services in paragraph 2 would be necessary.

18. On 24 July 2023, the EBA published its report on interdependent assets and liabilities in the NSFR under article 428f(3) of the CRR (EBA/REP/2023/24), where only limited recommendations concerning Covered bonds – i.e., Article 428f(2)(c)(ii) of the CRR; and Derivatives client clearing activities – Article 428f(2)(d) of the CRR; were made. The EBA now submits an addendum to its report published in 2023.

19. The EBA considers that, in view of new cases assessed, all types/cases of indirect derivatives client clearing activities – not only with the central institution of an IPS as intermediary between the CCP and the final customer's bank; do not seem to pose more funding risk than in the case of direct derivatives client clearing activities between the CCP and the customer's bank as clearing member directly, provided that the customer's bank does not provide to its clients guarantees of the performance of the CCP any other affiliated institutions in the case of indirect client clearing activities.

20. To ensure the necessary safeguards and to be specific on the list of products and services in paragraph 2 of the same article, the EBA recommends extending the amendments proposed in 2023 to all types of indirect derivatives client clearing activities, when institutions have in place also contractual arrangements explicitly stating that the institution does not provide guarantees of the performance of the QCCP or the affiliate facing the QCCP. Therefore, the following amendment in point d) of Article 428f(2) (changes to the current wording of the article are in **bold**) are reiterated: *"derivative client clearing activities, provided that the institution does not provide to its clients guarantees of the performance of the CCP or of the performance of the central institution in a cooperative network or institutional protection scheme,* ***or of the performance of any other affiliated institutions,*** *in the case of indirect derivatives client clearing activities, and~~, as a result,~~ does not incur any funding risk."*

1.3 Next steps

21. The EBA will continue to monitor some specific aspects of the LCR and NSFR due to current circumstances and the interest rate environment, in close cooperation with competent authorities. This, for example, includes work to more closely assess the implementation of

the consistency of currency denomination for the LCR set out in Article 8(6) of Commission Delegated Regulation (EU) 2015/61.[6]

22. The EBA will also work to take stock of the implementation of guidance provided in the 2nd (2021) EBA monitoring report. This includes application of Article 26(2) of Commission Delegated Regulation (EU) 2015/61 on outflows with interdependent inflows on which the EBA receives notifications, and the application of the treatment of fiduciary deposits in the context of online deposit platforms. Similarly, as mandated, the EBA will continue to monitor the transactions reported by institutions as interdependent assets and liabilities in the NSFR in cooperation with competent authorities in accordance with Article 428f(3) of the CRR.

23. In addition, EBA will evaluate whether any updates will be needed to the liquidity/funding part of the SREP framework in its forthcoming general update and as mentioned in the 3rd (2023) report, the EBA is working on reviewing the common reporting framework. Furthermore, the EBA is also closely involved in the work of the BCBS regarding the follow-up from the 2023 market turmoil.

[6] 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 (available here).

2. Final stance on inflows from open reverse repos

2.1 Background

24. In May 2024 the EBA published Q&A 2024_7053 on the LCR treatment of inflows as regards open maturity reverse repos which can be terminated at any point in time.

25. While stating that inflows cannot be recognised from open reverse repos if the option to call them within the following 30 days has not been exercised, this Q&A allows for recognising the relevant inflow if the institution can demonstrate to the supervisor that the open reverse repo would be called and effectively mature under certain circumstances, within the following 30 days.

26. Furthermore, in this Q&A, the EBA committed to provide guidance to support the evaluation of the demonstration by banks of the maturity of the open reverse repos within the following 30 days in this EBA Report on monitoring the implementation of the LCR and NSFR implementation in the EU.

2.2 EBA Guidance

27. Following Q&A 2024_7053,[7] for the recognition of inflows from open reverse repos in the LCR, supervisors should take into account if one of the following two approaches is applied.

28. Under any of the following two approaches, the supervisor is expected to consider that the institution has sufficiently demonstrated that the open reverse repo will be called and effectively mature within 30 days.

29. In the case that inflows were recognised from open reverse repos following this guidance and, however, ultimately the bank did not terminate the open reverse repo according to the guidance provided, the LCR calculation should be rectified without inflows being recognised.

[7] "As indicated in the Q&A 2021_6163 (available *here*), inflows cannot be recognised from open reverse repos if the option to call them within the following 30 days has not been exercised. This does not prevent the reporting institution from recognising the relevant inflow if it can demonstrate to the supervisor that the open reverse repo would be called and effectively mature under certain circumstances, within the following 30 days. In such a case the reporting institution may recognise inflows by applying the rates envisaged in Article 32(3)(b) of Commission Delegated Regulation (EU) 2015/61 and report them under C74 accordingly under item 1.2 "Inflows from secured lending and capital market-driven transactions" in the relevant row depending on the type of collateral.

Furthermore, in the context of its next monitoring report for the implementation of the LCR and NSFR, the EBA will consider providing additional guidance to support the evaluation of the demonstration by banks of the maturity of the open rev repos within the following 30 days."

30. This guidance does not apply to other transactions than open reverse repos like margin loans or similar products.

2.2.1 Approach 1 - Liquidity risk management policy of the bank

31. The liquidity risk management policy of the bank in place should include specific events whose occurrence shall trigger the call of the option of the open maturity reverse repo in a specific maximum period of time.

32. The inflows can be computed after the event is triggered once the time until the deadline established in the liquidity risk management policy to call the option is shorter than 30 days. Therefore, it is understood that upon the occurrence of the event, the inflows from the open reverse repo will be recognised once they contractually mature within 30 days.

33. By only showing that those events have taken place the bank would be demonstrating that the call to terminate the open reverse repo will be exercised. Consistently the liquidity risk management policy of the credit institution should not expect or imply that those transactions will be rolled over in times of stress.

34. To note that open reverse repos can be called at any time with one or two days of notice period.

2.2.2 Approach 2 - Historical observations

35. Observed experience that the bank does not roll over open reverse repos might serve as an argument to demonstrate reasonable expectation of exercise of the call.

36. These observations should be made over a period of stress, either idiosyncratic or market wide, of at least 30 days to ensure that reputational issues under such scenario, that might lead to renewal of the repos for franchise reasons, are taken into account.

37. The bank might consider the percentage that open reverse repos were not rolled over during the period of stress with respect to all the open reverse repos existing just before the stress events took place. Thus, the reporting institution would recognise inflows, in accordance with Article 32(3)(b) of Commission Delegated Regulation (EU) 2015/61, with respect to the same percentage of the open reverse repos existing at the moment of the calculation of the LCR assuming that upon stress those transactions would not be rolled over.

38. To be noted that the mere existence of the option to call the reverse repo at any time is not sufficient to compute inflows.

3. Operational deposits and excess operational deposits

3.1 Background

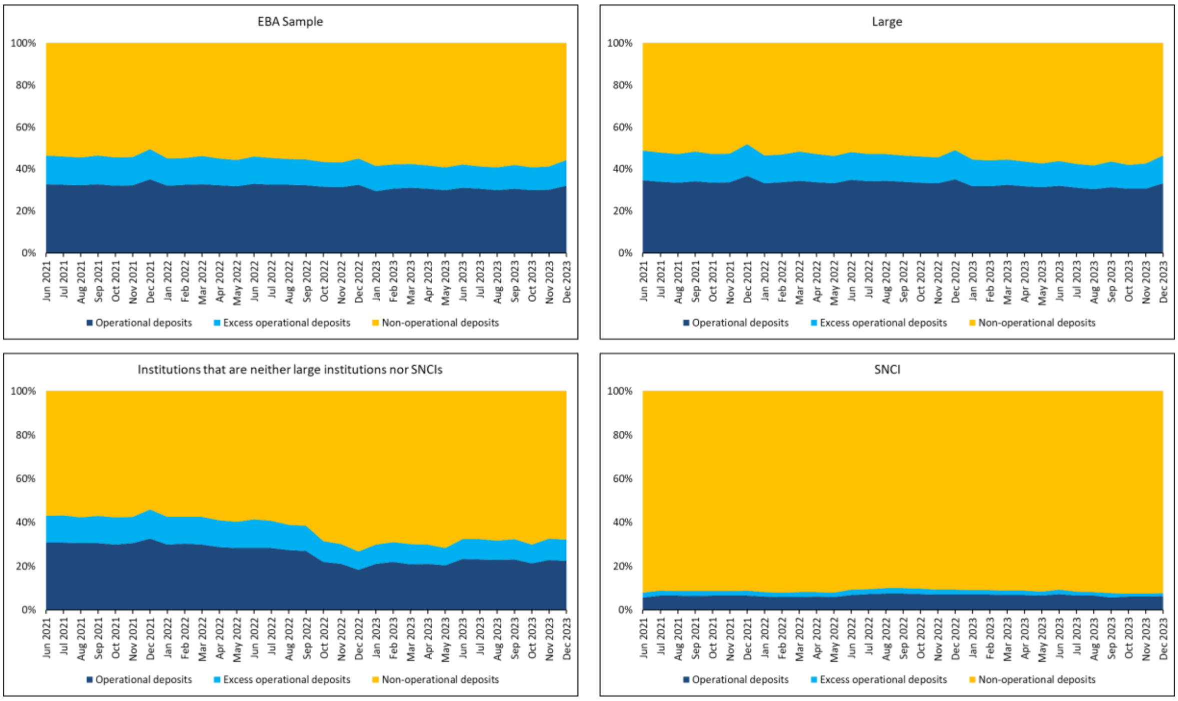
39. Operational deposits have a material preferential treatment as regards their applicable outflow rates in the LCR. The EBA provided guidance for the identification of operational deposits in the first report on monitoring of LCR implementation in the EU in 2019. This consisted of guidance on two aspects: (i) clarifying the identification of operational deposits and (ii) providing non-exhaustive examples of good practices in quantifying the amount of excess operational deposits. In the second report on monitoring of LCR implementation in the Union, published in 2021, following a review that the EBA conducted, EBA noted that competent authorities generally confirmed the implementation of the guidance that the EBA provided in 2019, which was a finding supported by data analysis.

40. Due to fluctuations in the amount of operational deposits as well as of excess operational deposits, which might impact LCR levels of institutions in the EU, the EBA has scrutinised the practical implementation of the practices suggested in the first EBA report. The outcome of such monitoring exercise is provided in this section.

3.2 Observations

41. Figure 1 shows the evolution of operational, excess and non-operational deposits for EU institutions, considering the full EBA sample, which consists of large institutions, institutions that are neither large institutions nor small, and non-complex institutions (SNCIs) and SNCIs, respectively. The amount of operational deposits is not subject to high fluctuations from June 2021 to December 2023 when looking at aggregate data. Generally, large and institutions that are neither large institutions nor SNCIs, report a larger amount of operational deposits compared to SNCIs.

Figure 1: Evolution of the share of operational, excess operational, and non-operational deposits (as a % of total deposits) for all EU banks.

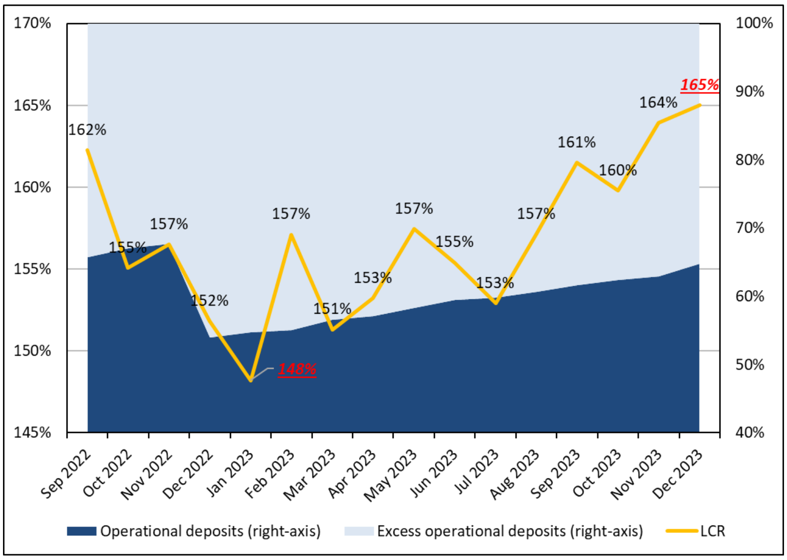


42. Since the amount of operational deposits in all EU institutions seems to not have fluctuated much over the period from June 2021 to December 2023 in an aggregated manner, the EBA has performed an analysis at institution level on those institutions in the EU that reported an increase in the amount of operational deposits. In the same vein, institutions that decreased the amount of the excess operational deposits from December 2022 to December 2023 have been also analysed.

43. In particular, the analysis focused on those institutions experiencing an increase in the amount of operational deposits and, at the same time, decreased the amount of the excess operational deposits (which suggests they re-classified deposits from excess operational deposits to operational deposits). These credit institutions are mainly institutions that are neither large institutions nor SNCIs - only 15% of them are large banks.

44. As shown in Figure 2, this subset of institutions is found to have increased, on a weighted average basis, their LCR values by around 15%-points, and NSFR values by around 2%-points from December 2022 to 2023. While the sum of operational and non-operational deposits has not fluctuated significantly (a maximum of 5%), the part of operational deposits that are non-excess is trending upwards, which seems to suggest reclassification from the excess part. It is to be noted, that in some cases, rather than reclassification of existing deposit amounts, EBA was informed it may involve a turnover of business with the new deposits having lower excess amounts.

Figure 2: Weighted LCR ratio of the 84 institutions increasing operational deposits and decreasing the excess operational deposits.



45. Beyond the quantitative analyses displayed in the previous paragraphs, the EBA has conducted a supervisory questionnaire with competent authorities to understand current practices of and observations from competent authorities regarding the LCR treatment of operational deposits.

   i. In terms of process, competent authorities informed that the development of operational deposits is analysed on a regular basis within the Liquidity-SREP and also within the top-down liquidity stress tests which are conducted on a yearly basis. Alternatively, some competent authorities includes this topic into their ILAAP/ICAAP investigations. However, it was noted that many competent authorities have not yet undertaken a systematic approach to ensure that the EBA guidance was actually followed by institutions under their remit, while assuming that institutions would act to comply with the guidance EBA provided in 2019. The EBA holds the view that also these competent authorities should develop structural approaches in their supervisory practices to monitor the trend of non-operational and excess operational deposits, and the related impact on the liquidity regulatory metrics, while adhering to the principle of proportionality.

   ii. In terms of substance, with respect to the:

      a. Identification of deposit accounts that may generally qualify as operational in general, most institutions were found by competent authorities to have in place a framework and mapping of deposits to the definitions under Article 27(1)(a) of Commission Delegated Regulation (EU) 2015/61. However, there might be some divergence in the way of how institutions demonstrate the existence of legal or operational limitations that make significant withdrawals within 30 calendar days unlikely, as required under Article 27(4) of Commission Delegated Regulation (EU) 2015/61.

b. Determination of excess operational deposits, competent authorities confirmed that institutions implement both quantitative methods provided in the first EBA report. However, quite some heterogeneity could be observed with respect to the length of the trade cycle being assumed by institutions, and the statistical measure being considered by institutions when analysing historical deposit balances or payment flows.

3.3 EBA guidance

46. The above observations may necessitate some further regulatory guidance, beyond those already reflected in the first EBA report, to further promote a level-playing field. More precisely:

i. With respect to the identification of deposit accounts that may generally qualify as operational, it is essential that institutions have a framework in place that provides for a proper and evidence-based mapping of deposits to the definitions provided in Commission Delegated Regulation (EU) 2015/61. In addition, with respect to the requirement under Article 27(4) of Commission Delegated Regulation (EU) 2015/61, institutions should be able to demonstrate the established relationship (e.g., already existing for some time, frequent transactions, not dependent on remuneration) and their process to identify legal/operational limitations for withdrawal (e.g., changes in the interest rate causing an economic disincentive to withdraw the deposits cannot be seen as an operational limitation). More generally, institutions should be able to demonstrate the critical importance of the service provided in relation to the deposit.

ii. With respect to the determination of excess operational deposits, the trade cycle should reflect the specificities of the business model of the client, being aware that:

a. The shorter the trade cycle assumed, the more volatile the amount being considered as excess operational deposit over time; and

b. The longer the trade cycle assumed, the lower the amount being considered as excess operational deposit.

The balance considered as operational should be restricted to the amount necessary to cover expected outgoing payments over the trade cycle. Furthermore, any balance above the expected outgoing payments over the trade cycle should be considered as excess operational deposit since the related amounts are not needed to meet operational payment needs linked to the operational service provided by the institution – since this excess balance can be withdrawn by the depositor without compromising the correct fulfillment of the operational service provided by the institution.

Moreover, institutions should refer to prudent statistical measures when analysing historical deposit balances or payment flows. For instance, in relation to the deposit-balance approach, additional scrutiny might be needed where reference is made to the minimum deposit balance (observed throughout the trade cycle) as indicator for excess operational deposits, especially when combined with a relatively long trade cycle.

4. Retail deposits excluded from outflows

4.1 Background

47. Retail deposits maturing beyond 30 days can be exempted from outflows upon compliance with some economic (material early withdrawal penalty) or legal/contractual (prohibition to be withdrawn within 30 days) related conditions. They can receive a preferential treatment which can materially impact the amount of outflows – Article 25(4) of the LCR Delegated Regulation; considering the share of these deposits in the liability side of banks and the reduction of the outflow rate by 10% or 5%. To be noted that retail deposits trigger outflows in the LCR irrespective of their maturity.

48. In 2019, the EBA published its first report on monitoring of LCR implementation in the EU, where guidance was provided on how to apply this preferential treatment, in particular related to the definition of material penalty for the application of that exclusion. In the second report on monitoring of LCR implementation in the Union, published in 2021, a review of the guidance provided in 2019 was conducted. Competent authorities and data generally confirmed the implementation of the EBA guidance, with the amount of exempted retail deposits decreasing during the period from March 2019 to September 2020.

49. Due to the increase of exempted retail deposits throughout 2023, which might impact LCR levels of institutions in the EU, the EBA has monitored the practical implementation of the practices suggested in the first report. The outcome of this monitoring exercise is provided in this section.

4.2 Observations

50. Table 1 shows the variation of exempted retail deposits between December 2022 and December 2023. Almost half of the EBA sample experienced an increase in the reported value of exempted deposits. The potential impact of this increase on the LCR is estimated to be small at aggregated level. In particular, the LCR value would decrease by 1.3 percentage points (p.p.) on average when assuming the increased amount of exempted deposits would not qualify as such.[8]

[8] The recalibrated LCR has been estimated by assuming a 5% outflow rate for the difference of the amounts of exempted deposits reported in December 2023 and December 2022.

Table 1: Variation of exempted deposits from December 2022 to December 2023.

Increase in exempted deposits	Number of banks	LCR reported	LCR recalibrated	Diff. LCR (p.p.)
0% < x	1378	166.9%	165.6%	-1.3
Of which:				
0% ≤ x < 10%	237	173.9%	173.4%	-0.4
10% ≤ x < 25%	342	165.7%	164.8%	-0.9
25% ≤ x < 50%	365	164.4%	163.1%	-1.3
50% ≤ x < 100%	231	171.3%	169.9%	-1.4
100% ≤ x < 150%	75	158.4%	157.6%	-0.8
150% ≤ x < 200%	30	240.3%	229.5%	-10.8
200% ≤ x < 400%	43	154.1%	152.4%	-1.7
400% ≤ x < 600%	14	187.4%	186.2%	-1.2
600% ≤ x	41	174.0%	173.0%	-1.0

51. Since the analysis at aggregated level does not allow for conclusions to be drawn, a focused analysis at institution-level has been also performed. Looking at those institutions that experienced an increase in exempted retail deposits between December 2022 and December 2023 allows identifying those institutions with the greatest impact on the recalibrated LCR. As shown in Table 2 below, when assuming the increased amount of exempted deposits would not qualify as such, 7 institutions would end up with a recalibrated LCR between 100 – 125%, while the other institutions would maintain LCR levels above 125%.[9] Despite this observation, also given the size of the sample, on the whole it can be noted that the potential impact observed is not material and higher impact is concentrated in a limited subset of institutions.

Table 2: Distribution of Recalibrated LCR for institutions increasing exempted deposits.

		Recalibrated LCR (x)					
		100% ≤ x < 125%	**125% ≤ x < 150%**	**150% ≤ x < 200%**	**200% ≤ x < 400%**	**x ≥ 400%**	**# of banks**
LCR recalibrated minus reported LCR (y)	**-25% ≤ y < -10%**	7	43	111	123	24	308
	-50% ≤ y < -25%	-	7	25	39	24	95
	-100% ≤ y < -50%	-	1	1	23	21	46
	-150% ≤ y < -100%	-	-	-	13	8	21
	-200% ≤ y <- 150%	1	-	-	-	4	5
	-400% ≤ y < -200%	-	-	-	1	8	9
	-600% ≤ y < -400%	-	-	-	-	1	1
	-600% ≤ y	-	-	-	1	6	7

[9] When recalibrating the LCR by including the exempted deposits in the calculation, the total outflows are considered higher than before, as previously exempted deposits now count towards the net outflow figure. As a result, the recalibrated LCR will reflect a lower LCR, entailing that the institution needs more liquid assets to cover the increased outflows. The recalibrated LCR is more conservative and accounts for the potential impact of including previously exempted deposits, which increases the denominator (outflows) in the ratio. The outcome is a more stringent measure of liquidity, reflecting a potentially less favorable liquidity position compared to the reported LCR.

52. In 2024, the EBA has conducted a questionnaire to assess the appropriateness of the guidance on modelling exempted deposits, provided in 2019. Overall, competent authorities mentioned that the application of the EBA guidance on exempted retail deposits is checked via onsite inspections, deep dives, horizontal analysis, ICAAP or SREP, outlier test and on a case-by-case where needed. Some competent authority claimed that there is no specific supervisory practice in place to check that the guidance is applied.

4.3 EBA guidance

53. While it is not entirely clear how much of the increased amount of exempted retail deposits would be subject to an early termination clause – and therefore to a material penalty in accordance with Article 25(4) of the LCR DR; it is clear that a correct implementation of the concept of materiality has gained importance. Competent authorities generally confirm that the 2019's guidance and its implementation is meeting its objectives and, based on experience gained, some additional observations as regards the implementation of a material penalty have arisen.

54. For example, regarding paragraph 62(d) of the guidance in EBA's 2019 report, it is observed that with the recent change in interest rate environment the condition that *"the interest rate of the early withdrawn deposit is substantially higher than the offered interest rates for similar products for reinvestment"* needs to be well understood. Particularly, a volatile interest rate environment could make it more likely that attractive product offerings from competitor banks appear. Against this backdrop, it may need to be considered that paragraph 62(d) is not easily met and that it may be more adequate to apply a more significant penalty – with an aim to qualify for paragraph 62(c).

55. As regards paragraph 62(c) of the 2019 EBA report, which highlights *"amount of the deposit to be received, in the case of early withdrawal, being materially lower than its principal amount",* it was observed that the assessment of *"materially lower"* can depend on various elements. For example, to the extent no or only little interest is accrued or paid out, such as at the start of the lifetime of a term deposit, the loss of this interest cannot be considered to contribute to a disincentive to redeem early.

56. Overall, data history of early redemptions on exempted retail term deposits should show that in all of those cases a material penalty was applied – or that hardship was applicable. This condition shall be met also during periods in which interest rates have gone up significantly.

5. Addendum to EBA Report on interdependent assets and liabilities in NSFR under article 428f(3) of the CRR

5.1 Description of new cases assessed

5.1.1 Update of assessment

57. While the CRR does not envisage a notification approach to the EBA of the cases where Article 428f of the CRR is applied, the EBA has benefited from contributions from EU competent authorities as regards those institutions under their supervisory remit applying Article 428f(1) or (2) of the CRR. This has allowed the EBA to understand the background, characteristics of the transactions in place, special arrangements, impact, etc. and to assess the compliance with and the effectiveness of the conditions envisaged in paragraphs 1 and 2 and whether potential amendments to the conditions in paragraph 1 or 2 would be necessary. This information has also been complemented with the available COREP data on the NSFR.

58. The EBA assessed the description of the new transactions on which Article 428f of the CRR has been applied. The EBA analysed if the conditions in paragraph 1 and the definition in paragraph 2 of Article 428f of the CRR were met by those products or services. The EBA also assessed if the conditions in paragraph 1 and the definitions in paragraph 2 ensure the absence of funding risk or whether any amendment is necessary for consideration.

59. All the transactions assessed, except those referring to Article 428f(2)(d) of the CRR, have been considered to be in line with the cases already included in the EBA Report published in 2023. Accordingly, the EBA has only limited additional recommendations to make at this stage, which concern derivatives client clearing activities in Article 428f(2)(d) of the CRR.

5.1.2 Focus on derivative client clearing activities

60. Eleven institutions apply the treatment of interdependent assets and liabilities as regards derivative client clearing activities in point (d) of Article 428f(2) of the CRR. Three of these institutions declare that they act as a pass-through between the client (liability) and CCP (asset) in both direct and indirect arrangements. All the rest refer to only direct arrangements.

61. These services are offered to clients who do not hold a clearing license or do not wish to be members of CCPs but have the obligation to clear some product classes. For example, this can be driven by domicile requirements for clearing members. They are given the

possibility to access the CCP via the institution. The institution does not guarantee CCP performance to clients, as per the standard documentation.

62. The structure of the indirect clearing is the following, for direct transactions:

63. The description of the interdependent assets and liabilities is the following, for indirect transactions:

5.2 Analysis of the conditions in Article 428f(1)

(a) the institution acts solely as a pass-through unit to channel the funding from the liability into the corresponding interdependent asset;

64. These institutions act solely as a pass-through unit. It is ruled by contract that the institution is not liable for defaults of the CCP, for both types of arrangements.

65. For the institutions involved in indirect client clearing transactions, it is understood that the client clearing agreements contain a contractual acknowledgement that the performance and payment of obligations owed by the institution (as clearing service provider) to the client is limited by and contingent on the actual performance or payment by the CCP, intermediary broker and any account bank, custodian or other third party holding cash, margin or other property for the entity which relates to the client. This contractual acknowledgement applies whether the bank clears for clients through a direct membership of the CCP or indirectly, through an affiliated or third-party intermediary.

66. For both types of transactions, the institution passes both the variation and the net Initial margin to the CCP either directly or indirectly via an affiliate.[10]

(b) the individual interdependent assets and liabilities are clearly identifiable and have the same principal amount;

67. The derivative client clearing transactions are recorded in separate books and clearly identifiable. Assets and liabilities are recorded with matching values/characteristics and have the same principal amount. The applied margin calculation is the same in both sides.

[10] This treatment was already highlighted and assessed in the context of the 2023 EBA Report on interdependent assets and liabilities in the NSFR for both variation and initial margins.

(c) the asset and interdependent liability have substantially matched maturities, with a maximum delay of 20 days between the maturity of the asset and the maturity of the liability;

68. Each pair of interdependent assets and liabilities is recorded with matched maturities. In most cases, it is mentioned that the assets and the liabilities are settled on the same day and on a daily basis.

(d) the interdependent liability has been requested pursuant to a legal, regulatory or contractual commitment and is not used to fund other assets;

69. The interdependent liability is not used to fund other assets as it is passed through immediately after maturity. It is understood that a legal agreement with a clearing client is in place to clarify the relationship and responsibilities of both parties. The bank's service in this regard is to provide access to the CCP and to accept and clear trades which fall within the clearing limits, products and eligibility while the client is then responsible for paying its margin (i.e. interdependent liability) and staying in compliance with the provisions outlined in the clearing agreement.

70. For those institutions involved also in indirect arrangements, the liabilities are covered by client clearing agreements with the institution, and the assets are covered by clearing broker agreements with a CCP, including for indirect clearing provided by an affiliate.

(e) the principal payment flows from the asset are not used for other purposes than repaying the interdependent liability;

71. It is guaranteed that the principal payment flows from the asset are not used for other purposes, as they are passed through to repay the interdependent liability. In particular, the client clearing transactions are in separate books away from the rest of the firm and ringfenced so that the book is always flat and not impacted by any other firm activity.

(f) the counterparties for each pair of interdependent assets and liabilities are not the same.

72. The counterparties for each pair of interdependent assets and liabilities are not the same. Indeed, one side of the transaction is recorded with the CCP as a counterparty and the other side of the transaction is recorded with the client.

73. For those institutions involved also in indirect arrangements, institutions declare that each transaction faces its client on one side and the CCP either directly or indirectly via an affiliate on the other side.

5.3 Impact observed

74. If these transactions were not treated as interdependent assets and liabilities, the corresponding netting sets would enter the calculation of the institution’s net derivative position according to Articles 428k(4) and 428ah(2) of the CRR. Gross derivative liabilities would be subject to 5% RSF according Article 428s(2) of the CRR, initial margin received in

derivative contracts subject to 0% ASF and initial margin posted for derivative contracts subject to 100% RSF regardless of the counterparty.

75. The provided description indicates that the application of Article 428f(1) hardly increases the NSFR value based on the most recent data point available at the time of the discussion of the report. Apart from one institution, the impact on the NSFR is very low.

5.4 Observations and recommendations

76. In its 2023 report, the EBA considered that indirect derivatives client clearing activities, with the central institution of an IPS as an intermediary between the CCP and the final customer's bank, do not seem to pose more funding risk than in the case of direct derivatives client clearing activities between the CCP and the customer's bank as clearing member directly, provided that the customer's bank does not provide to its clients guarantees of the performance of the CCP and the central institution in the case of indirect client clearing activities.

77. Accordingly, in paragraph 160 of the EBA's 2023 report on interdependent assets and liabilities in the NSFR, the EBA proposed the following amendment in point d) of Article 428f(2) (changes to the current wording of the article are underlined): *"derivative client clearing activities, provided that the institution does not provide to its clients guarantees of the performance of the CCP <u>or of the performance of the central institution in a cooperative network or institutional protection scheme in the case of indirect derivatives client clearing activities</u>, and~~, as a result,~~ does not incur any funding risk."*

78. The proposed amendment in Article 428f(2)(d) implies that this type of transaction shall pursuit a legal, regulatory or contractual commitment, also when performed indirectly. This implies that institutions shall have in place contractual arrangements where it is explicitly stated that the institution does not guarantee the performance of either the QCCP or the central institution in case of the IPS.

79. Equally, where there is an affiliate facing the CCP, the application of Article 428f(1) of the CRR for indirect derivatives client clearing activities raises the question whether contractual arrangements exist in which it is explicitly stated that institutions do not guarantee the performance of this affiliate. In terms of safeguards, the EBA recommends clarifying the need that no funding risk can be allowed to lie under any type of indirect derivatives client clearing activities for which the treatment of interdependent assets and liabilities is applied.[11] The EBA considers that, as for the cases assessed in 2023, the fact that the

[11] Even though no practices of institutions applying Article 428f of the CRR for derivatives client clearing activities with collateral transformation services have been observed, the EBA would like to clarify that, in all cases, activities listed under Article 428f(2) of the CRR must meet the requirements of Article 428f(1) of the CRR. Therefore, both direct and indirect derivatives client clearing activities (Article 428f(2)(d) of the CRR) with collateral transformation services are deemed not to meet the requirements of Article 428f(1)(a), which requires institutions to act solely as pass-through unit. Collateral transformation services involve the posting of collateral that is of a quality that is different from that of the collateral received, which implies funding risk and does not represent solely a pass-through activity.

institution does not provide guarantees of the performance of the QCCP or the affiliate facing the QCCP, is a necessary condition to ensure absence of funding risk but still not sufficient itself and thus the wording *"as a result"* might be misleading and lead to consider that the conditions in Article 428f(1) are not relevant.

80. For these purposes the EBA recommends extending the amendments proposed in 2023 to all types of indirect derivatives client clearing activities, when institutions have in place also contractual arrangements explicitly stating that the institution does not provide guarantees of the performance of the QCCP or the affiliate facing the QCCP. Thus, the following amendment in point d) of Article 428f(2) (changes to the current wording of the article are in **bold**) are reiterated: *"derivative client clearing activities, provided that the institution does not provide to its clients guarantees of the performance of the CCP or of the performance of the central institution in a cooperative network or institutional protection scheme,* ***or of the performance of any other affiliated institutions,*** *in the case of indirect derivatives client clearing activities, and~~, as a result,~~ does not incur any funding risk."*

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