



The way the upcoming Liquidity Ratio is already impacting the business model of banks and some specific views of DZ BANK AG

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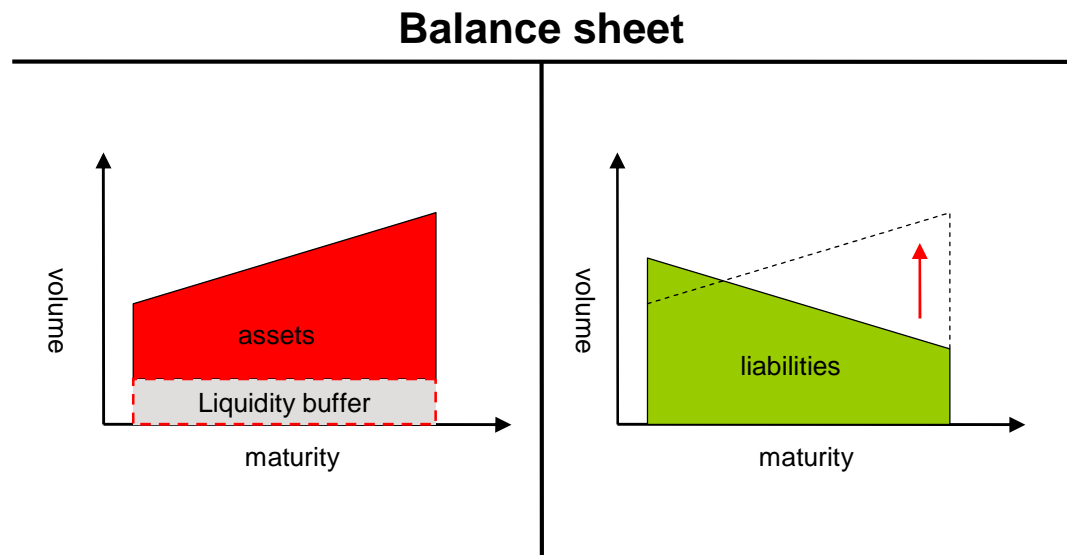
Frankfurt/Main
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BASEL III Liquidity Requirements

Requirements due to LCR and NSFR



- ➔ Quantified liquidity buffer of at least 25 % of liabilities < 30 days
- ➔ Restriction of structural liquidity mismatches

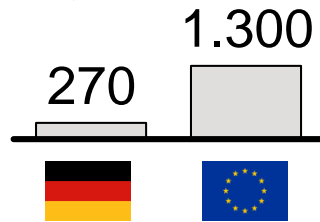
New regulations presumably have significant implications for the broader banking market

EXAMPLES

Need for banks to take action due to Basel III regulation*

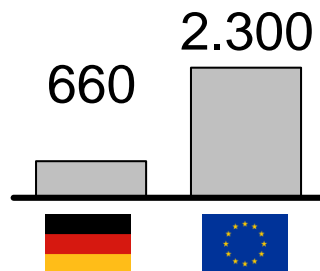
Liquidity requirement

Bank view, in EUR bn



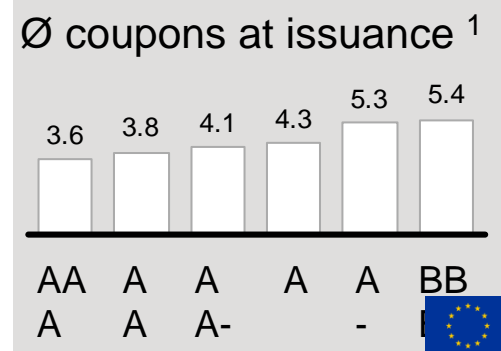
Need for stable refinancing

Bank view EUR bn



Implications in the broader banking market

High yield requirements for bank bonds



- Already far higher yield requirements with respect to other senior unsecured bank bonds
- Rising liquidity requirement implies higher yield requirements – including for DZ BANK
- Due to high wholesale costs prices are also rising with respect to retail deposits







Keener competition for deposits

4% on deposits

4.5% on 12-month money

1 5-year euro-area banks fair market curves, Bloomberg, 12.4.2011, * data source by McKinsey

International examples already show far-reaching measures in competition for retail deposits

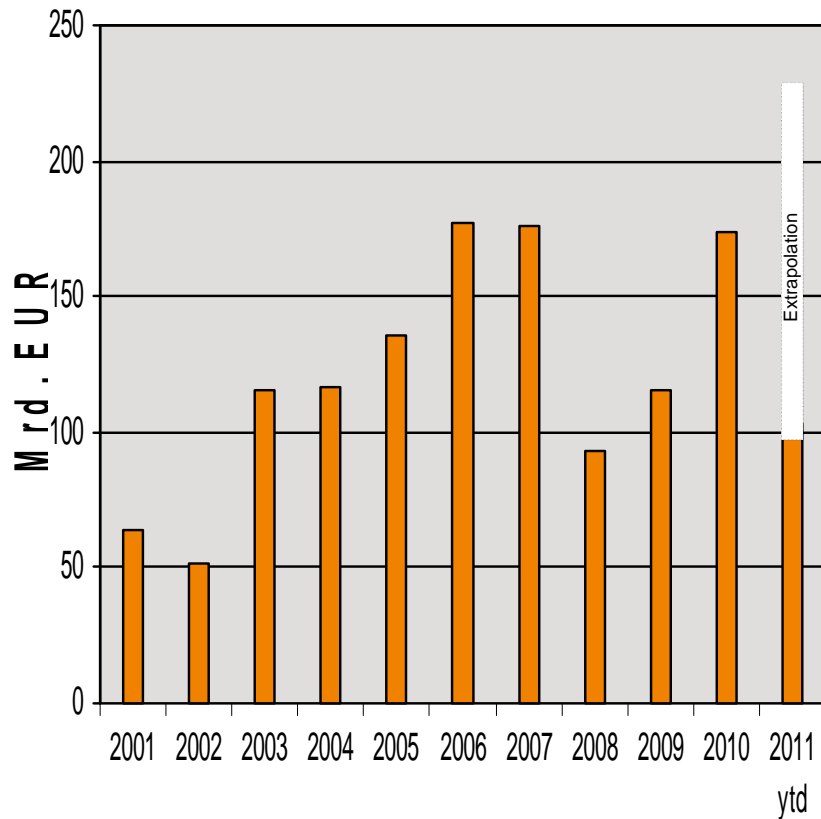
Area	Description	Examples	Main impact	
Product	– Introduction of innovative product features		No interest is paid but customers can get car or bicycle	Volume
	– Pooling of various products as supplement to the savings account		Savings counted towards paying down mortgages	Stability
Customer	– Deep analysis of customer behaviour and needs ; targeted customer pitch		Products tailored for different professions (e.g. free lancers, doctors)	Volume
	– Customer pitch acc. to life phase		Packages offered for different life phases	Stability
Price	– Dynamic pricing with attractive rates for limited period or with special conditions		6-month bonus interest rates for new customers	Volume
	– Variable prices to maximize revenue and limit churn rate		Unbeatable interest rates for last month of the term (up to 10%)	Stability

The direction of the action German banks need to take is dictated by regulatory requirements

<p>LB  BW</p> <p>Deutsche Bank </p> <p>„DekaBank</p> <p> Bayern LB</p> <p> HypoVereinsbank UniCredit Group</p> <p>COMMERZBANK </p>	<p>Liquidity Coverage Ratio</p>	<ul style="list-style-type: none"> – Increased investment in government bonds and high-grade Pfandbriefe/corporate bonds – Secure the classification of corporate deposits for operating purposes (25% outflow instead of 75%) – Secure a differentiation between stable and less stable retail deposits (5% outflow instead of 10%) – e.g. By improved data bases
<p>Net Stable Funding Ratio</p>	<ul style="list-style-type: none"> – Increased canvassing for retail deposits – e.g. by way of cross-selling or special offers – Ensure the classification of retail deposits as stable (90% eligibility instead of 80%) – Exit plans for non-strategic assets 	

Impact on refinancing

Issuance volumes in the covered bond market

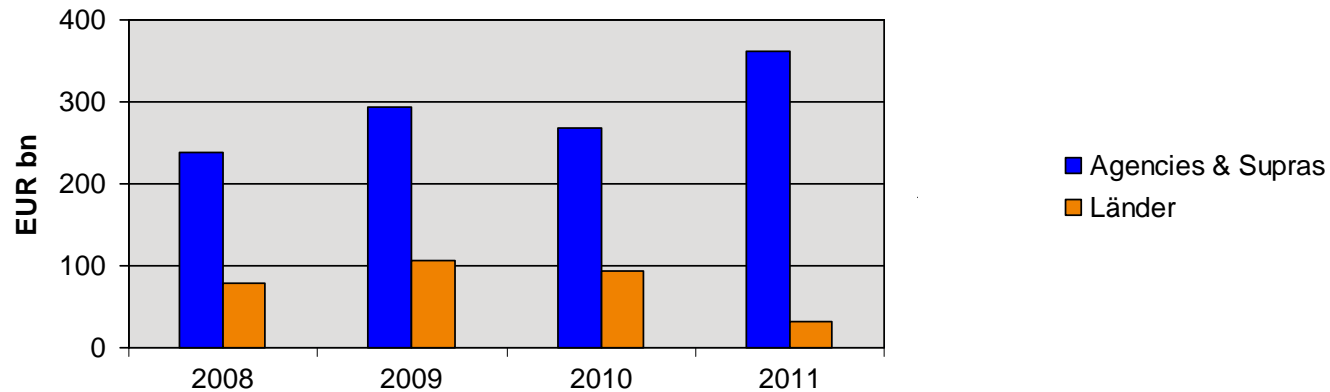


– Customer deposits

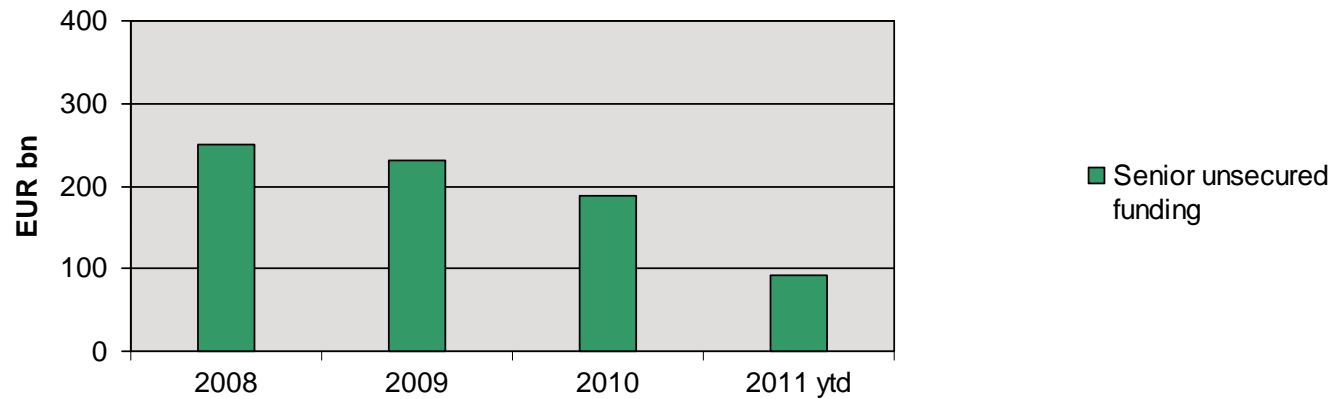
- Most important and stable funding source
- Increased competition
- Price pressure
- Further measures due to new liquidity ratios
 - Assets partly outsourced into SPVs/funds
 - Increased collateralised funding
 - Expansion of long-term funding from institutional investors
 - Review of non-core activities under Basel III liquidity/capital costs

Impact on refinancing

Funding plan Agencies & Supras



Senior unsecured funding (only EUR deals)



3. Impact on the bank's assets side

General statements:

Limitations for banks without adequate funding sources

Dearer liabilities-side due to tougher competition and lengthening of the funding's duration is transmitted to pricing in the lending business

A homogeneous market trend is not to be expected

Signs of partly strategic, partly operating implementation

Transfer pricing – option price components in lending operations

Credit and liquidity lines

Restructuring of banks' liquidity reserve
→ From profit to cost centre

Medium-term consequences

General statements

Greater importance of retail customer deposits

Lengthening of the duration of banks' liabilities side

Growing market for collateralised capital market products

Increased demand for assets eligible for Level 1 and Level 2

Tendency to pass on funding costs more on the asset side

Tendency towards diminished intermediary function for banks

Liquidity balancing function of the money and capital markets between banks is permanently limited

Credit spreads of senior unsecured bank bonds remain high

Liquidity spreads will also tend to remain significantly higher after the crisis

Regulatory liquidity requirements tend to lead towards increased consolidation pressure at the banks

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Current situation and challenges

- **Liquidity** proved to be a **critical factor during the financial crisis**: the combination of inadequate liquidity-risk management and the drying up of external sources led to **liquidity bottlenecks** at many banks. In order to avoid this in the future, the regulators reacted by **introducing liquidity ratios**.
- The **cooperative financial network is organised together with its central institutions DZ BANK and WGZ BANK as a liquidity pool**. The central institutions act as a central “**liquidity market place**”: Surplus liquidity at individual banks is pooled in the central institution and immediately made available as the need arises.
- **CRD IV now lends the liquidity balancing function** within the financial network – which was still too little heeded in Basel III – better **possibilities for inclusion** in determining liquidity ratios. First, due to the so-called **central institution privilege** and, second, to the **option of a group waiver** – in other words the collation and reporting of ratios for the cooperative financial network as a whole.

Current activities:

- **DZ BANK** has set up its own **Liquidity Task Force** to examine current challenges and possible options for action. This task Force coordinates **closely** with the Capital Expert Committee and the internal “Regulatory Developments” working group. In addition, **there is a close relationship carried out under the leadership of the BVR** in the interests of the cooperative financial network with regard to issues such as liquidity, capital and large loans (leverage ratio).

For 125 years the core task for the central institution:
ensure liquidity balancing in the financial network



DZ BANK's role as a liquidity and risk manager:

- Accept unlimited deposits from the cooperative banks at all times
- Short- and long-term refinancing for the cooperative banks
- Internal financing of the DZ BANK Group
- Risk taker of counterparty and market price risks for the cooperative banking group
- Clearing of liquidity risk positions
 - short term liquidity risks
 - Match maturities

DZ BANK's liquidity balancing function greatly impaired by Basel III

DZ BANK's role

Liquidity balancing function in the cooperative financial network as a **core task of the central institution** for over 900 cooperative banks

- The cooperative banks' deposits are accepted at all times
- Assumption of liquidity risks
- ➔ No liquidity problems during the financial crisis

Liquidity
clearing
function

Risk caused by new regulation and the tougher market environment it creates

Stricter regulation

- New ratios under Basel III (LCR / NSFR) place heavier requirements on future liquidity management and refinancing
- Insufficient account taken of interdependences within the financial network as ratios have to be reported at the individual bank level

Market environment

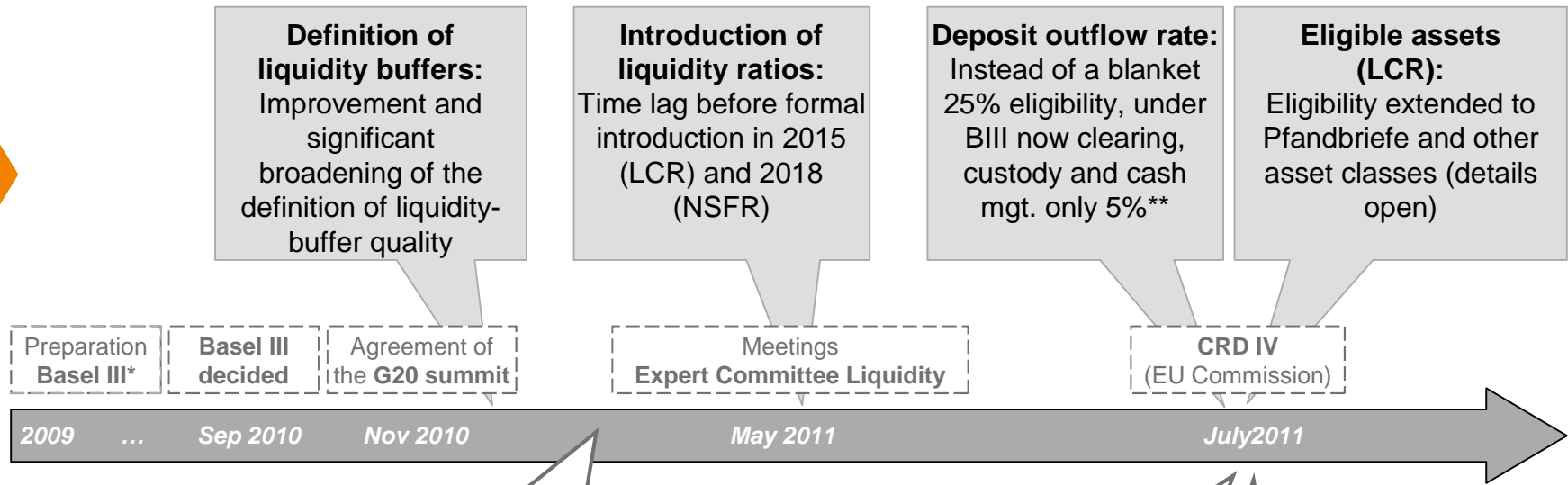
- Liquidity costs have been far higher since the crisis
- Increasing competition for structural liquidity

New regulations will influence the intermesh between central institutions and cooperative banks as a single unit – and thus one of DZ BANK's core functions

Improvements have already been obtained

– approach within the financial network is still open

Banking market as a whole



Especially the financial network

Central institution/network privilege:
Establishment of special treatment for liquidity at central institution networks in Basel III principles

(Calculation of inflows and outflows with respect to LCR)

Option network waiver:
Alternative for non-consolidated banking groups stipulated in the EU Ordinance

Central institution/network privilege:
Special treatment of liquidity at central institution networks is kept

Multi-layered implications for the cooperative financial network due to market and regulatory changes



Sparda-Bank

Market and regulatory changes

- Keener competition for retail deposits drives refinancing costs
- Local cooperative banks expect higher liquidity prices for short-term deposits (sustainability)
- Higher prices for unsecured bank bonds due to lack of eligibility for the liquidity buffer
- Upgrade of liquidity buffer portfolios to Level 1 and Level 2 assets



Control measures

