Consultation response

Draft Guidelines (revised)

on methods for calculating contributions to deposit guarantee schemes under Directive 2014/49/EU repealing and replacing Guidelines EBA/GL/2015/10

October 2022

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on EBA's consultation on methods for calculating contributions to deposit guarantee schemes under Directive 2014/49/EU repealing and replacing Guidelines EBA/GL/2015/10. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and otherfinancial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

Consultation Questions

Question 1: Do you have any comments on the proposed changes to the addressees or definitions in the Guidelines?

The EBA has observed that not all failures of a bank automatically lead to the use of DGS funds while other forms of DGS interventions using DGS funds might be necessary to stabilize an ailing or failing institution. In this regard, we note that use of DGS may also be a feature of discussion in the anticipated CMDI package. We would like to stress that a DGS's primary role is to protect covered deposits. Use of any of the other available range of measures should be on the premise that use of any such measure is not used to keep non-viable banks operating. It is important to avoid creating competitive distortions and moral hazard, and to ensure that banks can exit the market in an orderly and safe manner. It is also very important to retain the condition that use of any measure is of least-cost to the DGS fund, and to ensure consistency, the least-cost test itself should be clearly defined in the EU legislation.

We refer you to AFME's position paper for a more detailed industry views related to the upcoming CMDI package. (See: link)

Question 3: Do you have any comments on changing the reference from the 'annual' calculation of contributions to the 'periodic' calculation of contributions and on the clarification to set the periodic target level in section 4.2 of the Guidelines?

Paragraph 17 of the new EBA guidelines on contributions indicates that in the event of DGS intervention and recourse to borrowing, loan repayments will be limited in time in order to maintain the available resources at least 2/3 of the target level of resources. On the contrary, the 6 year replenishment period specified in the DGSD directive should be used.

No new or more constraining requirements than those specified in the DGSD should be created, which could entail pro-cyclical effects in case of general economic stress.

Question 7: Do you have comments on the proposed changes to the minimum weights of core indicators and the maximum weight of any indicator, as set out in section 4.5 (ii) of the Guidelines?

Since the EBA's objective is to achieve a better dispersion by risk category, we do not understand why the EBA has not increased the minimum weight of the NPL ratio, while it indicates in its analysis that there is a strong correlation between the level of NPLs and the recourse to Deposit Guarantee Schemes.

Question 8: Do you have comments on the proposed changes to the formula to calculate minimum contributions, as set out in section 4.6 (i) the Guidelines?

Appreciating the risk-orientation of the revised calculation of DGS contributions, we suggest to further harmonize the calculation system in itself. Since with this proposal dynamic risk-based contributions need to fulfill a still static target (0.8%), there are two conceptually opposing parameters which are aligned by means of an adjustment coefficient.

To achieve (A) a static 0.8% target with (B) dynamic risk contributions, (C) an adjustment coefficient is introduced.

B x C = A
Risk-based contributions x coefficient to meet target = target level of covered deposits

In principle, an adjustment coefficient is a good idea to align a moving target to a static target, however, only including an aligning adjustment coefficient may produce a similar result to the existing methodology as the coefficient corrects the risk-based contributions to finally meet the static target, hence calibrating it towards a contribution result when simply applying a multiplier of 0.8 x covered deposits without any risk-based calculation. However, we would suggest to <u>adjust the actual target level to a risk-based calculation</u> as well to align it with the risk-based character of the contributions.

B x C = A x **D**
Risk-based contributions x coefficient to meet target = target level x **risk-based coefficient**

The underlying risk assessment should be based on certain risk factors decisive for a potential access of the DGS, such as factors impacting the likelihood to access the DGS at all, such as the Own Funds and MREL eligible liabilities available at a bank before any DGS pay out might be effectuated. This could include taking into account any available Own funds and eligible liabilities beyond the minimum regulatory requirement. These factors would decrease the probability of a DGS pay-out because capital and MREL can be used for loss absorption and recapitalization and an orderly restructuring of failing banks (in particular with an open bank bail-in) without the need to resort to DGS funds will be necessary for a potential depositor[1] pay-out. The significant levels of Own Funds and eligible liabilities bank have to maintain also decrease the likeliness of a bail-in reaching the more senior depositor layers that could result in DGS fund liability due to the mandatory exclusion of covered deposits from bail-in. If a bank is in the remit of the Single Resolution Board (SRB), for which a resolution strategy is determines, it has to follow certain resolution planning requirements such as developing playbooks for crisis cases, and contingency plans. All these products are in itself risk-decreasing measures to protect depositors, i.e. one of the resolution objectives. Consequently, the level of these risk buffers and measures should form a risk-based coefficient between 1 (no risk-decreasing measures in place) and 0.625 (there are risk-decreasing buffers and measures in place, e.g. capital and MREL requirements, the surplus above these minimum requirements and banks with resolution strategy, especially if bail-in applies). Notwithstanding the potential reduction, the regulator may stipulate a minimum target level of 0.5% covered deposits.

Question 12: Do you have any further comments regarding the proposed revised Guidelines?

Date of Application

Whilst no date of application is mentioned, we understand that the EBA would like the guidelines to be effective as soon as possible after publication. The operational implementation of these new calculations, however, will require time and from a legislative transposition and legal consistency viewpoint - a quick implementation would also be very difficult.

As such, whilst the industry would welcome clarity with respect to any new calculations in the short term, and banks will seek to implement the new guidelines as soon as practicable, a transitional period to implement the new calculations should extend to 31 December 2023.

Target Level

Risk-based measure

The current target level may differ from 0.8% due to national discretions. For maintaining a level playing field under European regulations without national discretionary fragmentation, a range between 0.5% to 0.8% target level based upon certain risk factors should be clearly stipulated at European level.

The concrete target level should be risk-based, in alignment with the risk-based contributions. For determining the level on the range between 0.5% to 0.8% certain risk factors should be taken into account, which decrease the likelihood of a DGS pay out, such as the level of MREL and the excess of MREL beyond the regulatory requirement, level of capital and excess of capital beyond the regulatory requirement. These criteria would decrease the probability of a DGS pay-out because capital and MREL will be consumed first before any potential bail-in is implemented, hence before any DGS funds will be necessary for a potential depositor[1] pay-out. Moreover, if a bank is in the remit of the Single Resolution Board (SRB), for which a resolution strategy is determines, it has to follow certain resolution planning requirements such as developing playbooks for crisis cases, and contingency plans. All these products are in itself risk-decreasing measures to protect depositors, i.e. one of the resolution objectives. Consequently, the level of

[1] Depositor in this instance refers to a depositor for whom deposits are legally excluded from bail-in.

these risk buffers and measures should form a risk-based coefficient between 1 (no risk-decreasing measures in place) and 0.625 (there are risk-decreasing buffers and measures in place). Notwithstanding the potential reduction, the regulator may stipulate a minimum target level of 0.5% covered deposits.

Additional scenarios

We appreciate the scenario in which the annual target level is adjusted to reflect macroprudential environment for avoiding contagion. Further examples may facilitate concrete actions by competent authorities to actually decrease the annual target level.

Transparent criteria for assessing banking sector concentration

The current regulation provides for some ability by certain exceptions to apply a target level of 0.5% instead of 0.8%, dependent on the concentration of the banking sectors upon approval by the national authority (see Article 10(6) DGSD). The criteria for the banking sector concentration are stipulated by a report of the Commission's Joint Research Center (JRC) which is not public. Hence, there is a lack of transparency in the assessments and the conditions for a positive outcome. To date, only one member state has qualified for the unknown definition. The criteria are understood to be based on i) the number of banks and the main market shared and ii) the probability if the fund will be used taking specificities of the market into account. These criteria are indicative and do not include any specific thresholds.

We propose more transparency on the indicative criteria for the qualification of concentrated banking sectors by including them into the EU legislation.

AFME contact
Sahir Akbar
Managing Director, Head of Recovery & Resolution
sahir.akbar@afme.eu
+44 (0)20 3828 2732