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***Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of some 4,500 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU alone.***

## EBF Response to EBA/CP/2014/27 –Draft Guidelines on Payment Commitments (PC)

**General Comments**

Objective of Payment Commitments

The industry does not believe that it was the intention of policy makers for payment commitments to be treated the same as that for cash funded payments. We strongly urge the EBA to reconsider its position on the neutrality of choice point in paragraph 30 and to arrive at a pragmatic treatment for both capital requirements and leverage for payment commitments, which allows banks to continue to support the EU economy while also moving to a more robust deposit guarantee framework.

The inclusion of payment commitments in the Deposit Guarantee Schemes Directive (DGSD) was intended to facilitate the achievement of the future target level of funding, particularly for those Member states which are not currently operating on a pre-funded basis or are still facing ex-post liabilities after the financial crisis. Recital 34 of the DGSD states that “It should be possible for the available financial means of DGSs to include cash, deposits, payment commitments and low-risk assets, which can be liquidated within a short period of time.” The inclusion of collateralised commitments allows Deposit Guarantee Schemes to have immediate access to funding when needed, without the need for banks to cash fund entirely upfront.

Therefore, we believe strongly that there should be advantages for payment commitments vs cash funded payments. Treatments are considered further in the next section.

Prudential and Accounting Treatment of Payment Commitments

The prudential requirements for payment commitments, as for all capital requirements, start with the accounting. The requirement that the commitment must be paid ‘upon simple and unconditional request of the DGS’ will result in the recognition of a liability and an expense to P&L under IFRS. As a result there will be an immediate negative impact on CET1. While this will be consistent with the treatment of cash funded payments and therefore meets the neutrality of choice objective in paragraph 30, it will not serve the purpose of aiding the transition to the new DGSD regime. An encumbered asset will also be recorded.

We consider that the treatment of all payment commitments, in all jurisdictions and whatever it is used for (Resolution fund or Deposit Guarantee fund), should be consistent, but different to that of cash payments. It is therefore up to each Member State to determine the extent to which payment commitments are allowed within the 30% limit provided by Article 10(3).

There are, therefore, two potential courses of action:

* Inclusion of a credit related trigger for payment, which would allow all payment commitments to be treated as off balance sheet, with an appropriate capital and leverage treatment.
* Provide a specific, and appropriate, treatment for payment commitments that neutralises the differences in accounting.

As regards capital treatment we suggest the following:

* Risk weight according to an unrated institution under the standardised approach (i.e. 100%) as the DGS is intended to repay depositors or finance a bank resolution.
* Credit conversion factor of 20% as an item carrying medium/low risk.

For leverage purposes, we think that the payment commitment should be ignored on the basis that the collateral given will already be included in both the capital and leverage calculations.

Prudential Treatment during Transitional Period and DGS Replenishment period

It is unclear how the future obligation to make payments during the transitional period and where replenishment of the scheme should be treated for prudential purposes. Given the intention to build up the finances of DGSs over time during both periods, we seek confirmation that no commitment need be recorded for either capital requirements or leverage.

Requiring exposures to be recorded for capital and leverage requirements would place an unquantifiable burden on banks that we do not believe was intended by policy makers.

Treatment of Collateral

Overall the EBF finds the collateral requirements (e.g. limits on concentration, currency etc) too restrictive as they would increase complexity for collateral management. We recommend to align collateral requirements under the DGS with a common generally accepted marketable securities definition. A common frameworks will help promote consistent interpretation e.g. of ratings and risk weights, and supervisory convergence. Please see the following general observations to Part 4-7:

*Part 4 Delivery of collateral by the collateral provider to the DGS*

The EBF agrees with the principle that the delivery of collateral should be in accordance with one of the modalities provided in the Financial Collateral Directive.

On point 14a, we note that if low-risk assets are maintained across jurisdictions outside of Europe - protection will need to be aligned to the relevant local regulations. In condition 14 (ii) the EBA objective is fine, but we note that DGS would not be the securities account holder.

On paragraph 14b, we do not see the advantages of title transfers for banks. Cash deposits into a DGS bank account instead of collateral management however makes sense as long as the cash deposit is not considered as a definitive cash contribution to the DGS until the payment commitment is called upon.

*Part 5 Criteria to assess the inexistence of third party rights to the collateral*

EBF agrees with paragraphs 16 to 18. However the task to ensure the unencumbrance of collateral is not for the DGS but morel likely for the custodian, which is managing the collateral through the Triparty Collateral Management (TCM) contract. For the reasons stated under Part 4 the DGS themselves do not intend to manage the collateral themselves

*Part 6 Criteria for eligibility and management of collateral*

On paragraph 19, the criteria should be those of ECB or the relevant central bank to accept collateral as REPO material. Therefore, no other criteria should be defined. The respective custodian or intermediary and the relevant central bank should designate which low risk assets in which mix of assets/currencies qualify for TCM and eventual REPO transaction with central bank.

On paragraph 20, the EBF does not agree to new criteria concerning collateral quality such as exposure limits, diversification etc. because of what is stipulated above under response to paragraph 19.

On paragraph 21, EBF does not agree (see response 20).

On paragraph 22, EBF does not agree (see response 20).

*Part 7 Haircut*

On paragraph 23 EBF agrees that haircuts should be applied to collateral for payment commitments.

On paragraph 24 EBF disagrees to define haircut details in the Guidelines. The definition of haircut should be those defined by the respective central bank for REPO transactions, respectively collateralised lending from the central bank to banks.

On paragraph 25, the EBF disagrees with this definition based on expected losses and expected time lapse to sale of the assets. Furthermore, expected losses on collateral are not an expertise of DGSs. The expected time lapse of sale of assets is not relevant, as it is not a given that for the financing of a DGS payout the assets will be sold, as this will potentially have negative impact on asset markets. Rather financing will be done through REPO through the market or through the respective central bank.

On paragraph 26, the EBF agrees however with emphasis on the haircut schedule as defined by central banks.

Potential for Competitive Distortion

The method of payment through "Payment commitments" is allowed, up to certain limits, by both the Directive of the Deposit-Guarantee Schemes as by the Regulation (EU) no 806/2014 (Regulation of the Single Resolution Mechanism. Nevertheless, only the Directive authorises the EBA to establish the guidelines for defining these payment commitments. This would likely evolve into the highly undesirable scenario in which there would co-exist two types of "Payment commitments" in Europe:

* Payment commitments with impact on the profit and loss account: Attending to the definition given by the EBA for the entire EU and only usable for contributions to the Deposit Guarantee Scheme (DGS).

Payment commitments without impact on the profit and losses account: discreetly defined by each Member State and used for contributions to the Resolution Fund (RF). It can be reasonably expected that the member States will take care to not impact in the profit and losses accounts of their banks.

This situation should be avoided. While we again reiterate our preference for payment commitments without impact on the profit and loss account, we would like to note the potential distortion of competition that would benefit, very significantly, those countries with predominance of wholesale- market-funded banks and that, therefore, have to pay more contributions to the RF than to the DGS, compared to other countries with predominance of deposit-funded banks and, therefore, with more obligations with the DGS than with the RF.

**Answer to specific questions**

**1. Apart from the admissibility requirements suggested in the present guidelines, which objective criteria do you think could be applied, notably in order to determine the overall amount of payments to be accepted in a given year, or to be applied to individual banks applying for the option?**

If additional objective criteria for acceptance of payment commitments are set out, such additional criteria should be set out on EU level, rather than by local DGSs. Application of different additional objective criteria for acceptance of payment commitments by local DGSs may lead to inconsistent application of DGSD in various Member States.

When it comes to spreading payment commitments over time, we are in favour of a flexible approach on this point. It is clear that in 2024 payment commitments should not make up more than 30% of the available financial means. During the target level build-up phase, DGSs will, however, be allowed to both overshoot and undercut the limit. This is because, for one thing, the starting position differs in many countries. Member states which have in the past already paid a large proportion of contributions in the form of payment commitments may need a transitional period to reduce this proportion in an economically acceptable manner. Furthermore, payment commitments can be used to support anticyclical assessment of contributions. Assuming that reporting of payment commitments without any impact on the P&L statement is possible, these could namely be used more heavily in economically trickier phases. In this way, the size of contributions could be kept stable but the strain on balance sheets reduced.

At the same time, DGSs should be obligated to define at the start of the target level build-up phase clear-cut criteria for the use and distribution of payment commitments.

**2. Do you agree with these provisions to be included in Payment Commitment Arrangements? Do you think other provisions should be provided?**

We believe that the requirements for the elements of payment commitment arrangements are, in principle, appropriate. However, we have fundamental reservations about the unconditional right for a DGS to claim payments on demand. Such a requirement is unnecessary and will, according to our reading of IFRS, have a highly adverse effect on the accounting treatment for DGS members. While there should be a right to claim for the DGS it should be conditional to a specific event that would require payment upon simple demand and would not unquestionably lead to accounting affecting the P&L statement.

Payment commitments should benefit from a specific prudential treatment or, otherwise, there will be no point or advantage in using them to pay up contributions to the DGS. In Portugal, a country that established the payment commitments system years ago, the need for a specific prudential treatment was recognised early on, and, therefore, payment commitments are registered off-balance sheet.

A revision is needed to clarify that a payment by a credit institution can only be required following a pre-defined event introducing contingency upon a future determinable event for which the likelihood of its occurrence can be assessed. As each payment commitment is secured by securities the proposed amendment would not result in an increase of funding risk for the DGS and will still be in line with the Directive’s objectives. We suggest to define the event as follows in Part 2 paragraph 11 b):

*11. the Payment Commitment Arrangement should at least include the following elements:*

*a) …*

*b) The irrevocable obligation for the credit institution to make the promised cash payment of the Payment Commitment Amount following a predefined trigger event, similar to a financial guarantee . In this case, the payment obligation would be contingent upon a future event that is determinable and for which the likelihood of its occurrence can be assessed in order to assure that payment commitments are accounted for as off-balance sheet contingencies. ~~time, upon simple and unconditional request of the DGS, without undue delay and at any rate no later than 2 working days from the receipt of the notice pursuant to letter (c) below.~~ The credit institution is obliged to make the promised cash payment in the following circumstances:*

*i) When the DGS recognises the need for an adjustment of the amount of payment commitments in relation to cash contributions, caused for example by a transfer of deposits and contributions to another DGS according to Article 14 (3) DGSD or any other event that results in an exceedance of the 30% limit of payment commitments.*

*ii) The assumption of an increased probability of liquidity needs due to where an institution infringes or, due, inter alia, to a rapidly deteriorating financial condition, including deteriorating liquidity situation, increasing level of leverage, non-performing loans or concentration of exposures, as assessed on the basis of a set of triggers, which may include the institution’s own funds requirement plus 1,5 percentage points, is likely in the near future to infringe the requirements of Regulation (EU) No 575/2013, Directive 2013/36/EU, Title II of Directive 2014/65/EU or any of Articles 3 to 7, 14 to 17, and 24, 25 and 26 of Regulation (EU) No 600/2014*

*In the above circumstance the payment must be made without undue delay and at any rate no later than 2 working days. The payment period is reduced to 1 working day in case early intervention or crisis management measures are applied on the credit institution by the competent or resolution authority. The arrangement should preclude any reduction in the Payment Commitment Amount, or any termination of the Payment Commitment Arrangement, without the consent of the DGS.*

The described provision would still be in line with the overall idea behind the DGSD. As each payment commitment is secured by appropriate collateral, the proposed provision would not result in any increase in funding risk for the DGS. Alternatively, the rules could be amended in order to state that the provisions allow for limitation in national implementation, i.e. that the regulations of a national DGS allow for the above mentioned specifications regarding payment requests.

Having in mind that DGSs are public authorities, we also have serious doubts whether the unconditional and irrevocable right to claim payments on demand is in line with the generally accepted prohibition of arbitrary public administrative action. In this context, two levels need to be distinguished in our opinion. The first level is the provision and availability of payment commitments as such. This level is unquestionably given thanks to the provision of collateral and the collateral management requirements. The second level is, however, the legality of the right to call up the available funds on demand. DGSs are usually public institutions or comparable bodies. The way these institutions act must be guided by the rule-of-law principle. This means in the present context that the guidelines should define objective criteria stipulating when drawing on payment commitments is possible and justifiable. Such criteria need not only be a compensation event but could also, for example, be the further specification of risks in general in the banking sector.

**3. Do you agree that a credit institution should pay in cash the Payment Commitment Amount, when its obligation becomes due, within 2 working days at the latest?**

Looking only at the availability period, a period of up to 2 days for honouring payment commitments appears reasonable. However, considering the new 7 day payout period, the timeframe for conversion of the payment commitments could also be closer aligned to the 7 payout period.

However, a requirement to pay payment commitment amounts in cash ignores the funding character of payment commitments and the collateral that has to be provided for these. Payment in cash of the equivalent amount is therefore only one way of honouring payment commitments. Alternatively, the DGS can realise the collateral provided under the payment commitment and liquidate it by, for example, borrowing against it accordingly. This may well be beneficial for the DGS. The guidelines should therefore stipulate liquidation timeframe, though the manner of liquidation should be left to the DGS.

**4. Do you agree with the option left to the DGS to enter into a Security Financial Collateral Arrangement (full ownership remains with the credit institution) or a Title Transfer Financial Collateral Arrangement (full transfer of ownership)?**

The EBF agrees with the option left to the DGS. The Title Transfer Financial Collateral Arrangement has the advantage to offer more direct access to the collateral for the DGS. On the other hand it is very demanding for the credit institution which loses the property of the collateral and the rights of gathering its proceeds. Therefore, a Title Transfer Financial Collateral Arrangement should be acceptable if the securities are held on securities accounts provided by a third party custodian. This way the proceeds of the collateral may be paid out to the credit institution. This solution would allow the DGSs to benefit from the advantages of direct access to the collateral and on the other hand this alternative would be less demanding from the credit institutions perspectives.

Furthermore, the provisions of Part 3 of the EBA guidelines should be revised to clarify that the existence of a payment commitment is linked to the risk that a credit institution contributes to the respective DGS. In other words, in the case where the credit institution discontinues its deposit business or joins a different DGS, the payment commitments made during the 12 months preceding the end of the membership should terminate without settlement.

Especially the latter situation shows that the termination of a payment commitment appears to be justifiable. Where a credit institutions switches to a different DGS, this leads to a reduced exposure for the old DGS and an increased exposure for the new one. Hence, the new DGS has to increase funding to cover the higher exposure either by means of increased general contributions or a specific contribution on the new member. However, having to settle the payment commitment with the old DGS as well leads to a double payment for the same exposure in this situation.

This assumption would further aid the accounting treatment under the IFRS Framework to treat payment commitments under a “going concern” assumption. According to Directives 59 and 49, under a going concern situation the conditions mentioned in paragraph 12.d).(iii, iv, and v) do not have economic substance, i.e. they are not “genuine”. In other terms there are no instances where the reporting entity would be required to accelerate the payment commitment in order to re-fund the DGS for an intervention aimed at covering its own depositors.

To accommodate a more favourable accounting treatment we suggest the following changes to paragraph 12 d (iii-v):

* to add “reflecting a situation of a gone concern for the institution” at the end of paragraph 12d iii, 12div and 12d v or “following a predefined default event, similar to a financial guarantee. In this case, the payment obligation would be contingent upon a future event that is determinable and for which the likelihood of its occurrence can be assessed.”
* In addition, we suggest a revision to clarify that the existence of a payment commitment is linked to the risk that a credit institution contributes to the respective DGS. The payment commitment would therefore terminate without settlement when the credit institution does no longer have any deposits covered by the respective DGS. The payment commitment can be reduced or even terminated given that his is in line with the contribution of the credit institution to the overall exposure of the DGS.
* We suggest to amend paragraph 12 e as follows:

*In case of (i) authorisation withdrawn and (ii) the institution ceasing to be member of DGS -  other than reflecting a gone concern situation - the commitment is re-allocated to the other members of DGS, proportionally to their share of covered deposits on total deposits.* ***The commitment of the institution is cancelled and the payment commitment amount is returned.***

In this context, the requirement to annually amend or supplement payment commitments should be clarified so that it also allows for adjustment to reflect the actual current exposure contribution of a credit institution. In other words, the payment commitment can be reduced or even terminated given that this is in line with the contribution of the credit institution to the overall exposure of the DGS.

**5. Do you think other requirements about the choice of the custodians should be provided under these guidelines?**

We agree that the default or insolvency of a custodian should not lead to losses to the credit institution or to the DGS. We agree that there should be full segregation in the books of the custodian, and we agree that in the books of securities account providers higher up the custody chain there should be segregation between proprietary assets of the account holder and client assets of the account holder. We believe that this does create the conditions for collateral supplied to a DGS both to be bankruptcy-remote, and to be readily available in the event of bankruptcy of an intermediary.

We suggest that the words “full segregation” be clarified to ensure that there is no risk that the words “full segregation” be interpreted to mean that there is an obligation for assets held as collateral for DGSs to be segregated in special “DGS collateral” accounts right up the custody chain. If this were to be the case, then this would very significantly impede the provision of collateral management services to DGSs, and would increase cost and risk in the provision of such services without leading to any increase in legal certainty.

**6. Do you agree on the requirements suggested for the eligibility of collateral? Would you suggest other limits on concentration in exposures?**

The EBF has not specific comment.

**7. Do you consider appropriate not to consider the currency of issuance when determining whether debt instruments are correlated to an event of DGS pay-out, be it inside or outside the euro area?**

We believe that it is appropriate not to consider the currency of issuance when determining whether a debt instrument´s value is correlated to an event of DGS pay-out, be it inside or outside the euro area.

**8. Do you consider that the proposed wording correctly applies the concept of proportionality, or whether some limits to concentration should be envisaged also for smaller, locally operating banks?**

The EBF does consider that the proposed wording correctly applies the concept of proportionality.

**9. Do you agree with the criteria on the eligibility of the collateral provided in this Part 6? Do you think other requirements should be provided in these guidelines on this issue?**

Please refer to the general comments section.

**10. Do you agree with the criteria on the haircut provided in this Part 7? Do you think there are other requirements which should be provided under these guidelines about this issue?**

Please refer to the general comments section. EBF does not agree that haircut requirements should be detailed in the guidelines. The Guidelines should refer to the haircut schedule of the respective central bank for accepting collateral for central bank lending to banks.

**11. Do you agree with the prudential approach suggested? Would you suggest further details on the methodology to be applied, and if so which ones?**

Yes. We agree on the suggested approach but not on the last part of the last sentence of paragraph 33.

We agree that the competent authorities should assess within the supervisory review and evaluation process, the risks to which the capital and liquidity positions of the credit institution would be exposed should the DGS called upon it to pay the commitment. The prudential treatment should reflect this assessment.

As DGS remain national, the treatment should reflect the probability that the DGS is called upon and the potential losses stemming from a DGS intervention, on a net basis after potential recoveries from the bankruptcy estate of the failed institution.

The contributions of the DGS to resolution are limited to the lesser of:

1. the amount of losses covered depositors would have borne in insolvency, or
2. 50% (or a higher percentage set by the member state) of the target level of the deposit guarantee fund.

Moreover DGS subrogating to the rights and obligations of covered depositors in insolvency have the same priority ranking which is higher than the ranking provided for the claims of ordinary unsecured, non-preferred creditors.

Generally speaking DGS payment commitments represent only a small part of the own funds requirements (2 or 3 %) or of the liquid assets and when they are called they will not jeopardise the capital and liquidity position of a bank.

These two elements should be assessed by the designated authority on a national basis and risk-weighted accordingly. As a measure of simplification, we propose the payment commitments to be risk-weighted as an unrated institution under the standardized approach (i.e. 100%) with a credit conversion factor of 20%.