20 January 2015

**Draft Guidelines on contributions under Directive 2014/49/EU on deposit guarantee schemes**

**FGDR’s contribution to EBA’s consultation**

FGDR (« Fonds de Garantie des Dépôts et de Résolution ») is the French deposit guarantee scheme.

FGDR welcomes the consultation launched by EBA about the guidelines on the calculation of contributions to DGSs. The draft Guidelines present helpful orientations for EU DGSs to build risk-based contribution systems aligned with DGSD2 requirements.

FGDR is not going to offer comments on the way risk factors should be computed and included in calculations. Still, FGDR would like to express concerns about the general formula for contributions as proposed by the draft guidelines (question Q1). This formula echoes the general approach used for non-life insurance business, which hardly characterises the current environment for EU DGSs now the Banking Union is underway. It would lead to adverse effects for those Member states who want to stabilise their DGS’s resources level when the target level is reached.

Q1. Do you have any general comments on the draft Guidelines on methods for calculating contributions to DGSs?

1. **The draft guidelines focus on the resources building phase for undercapitalized EU DGSs.**

The draft guidelines stand on a mechanism of annual contributions accumulation. Annual contributions are determined with applying a contribution rate to the amount of covered deposits of a given institution, adjusted by risk factors.

Explicitly through the contribution rate, implicitly through the formula itself, this proposal is also clearly based on a resources building objective for DGSs. This is unsurprisingly linked to the fact that some DGSs have to transition from an ex post funding mechanism to an ex ante funding system and that some others are undercapitalized under DGSD2 requirements (resources in proportion of DGS’s liabilities, with a minimum between 0.5 and 0.8% of covered deposits).

But the proposed contribution calculations do not take into account any other objective or phase than resources building. Still, other EU DGSs have already reached and overpassed DGSD2 target level; sooner or later, they could consider stabilising their level of resources. In addition, contributions calculations might need taking into account the constraints of the stabilization phase even during the resources building phase; the formulations would also better stay the same at any time, whatever the phase is.

1. **With the new framework created by SRM and DGSD2, Member states covered by the Banking Union may be legitimate in looking for a stabilization of the level of resources of their DGSs after reaching the required target.**

Most DGSs in the world use a premium system without really managing their resources level:

* either contributions accumulate without any monitoring in anticipation for payouts to come;
* or, beyond a given level, reached or not reached, DGSs slow or plan slowing the rhythm for raising contributions in order to avoid unnecessary sterilization of banking resources.

For Banking Union Member States, it seems difficult to justify accumulating contributions with no limit and sterilize banking resources useful to the economy, now that new and powerful mechanisms have been created in the EU for resolving institutions, backed by ex-ante financing:

* the Single Resolution Mechanism, with the newly created Single Resolution Fund, are to take over, at least for the most important or systemic crises, from the protection brought by DGSs themselves;
* covered deposits are now acknowledged a higher ranking in the creditor hierarchy, which decreases the risk for a DGS to be hugely called in resolution
1. **The draft guidelines follow the general framework designed for non-life insurance business; this framework does not fit with Banking Union DGSs’ current environment and role any more.**

As it appears in the proposed formulation for contributions[[1]](#footnote-1), the draft guidelines are engrained in the conventional framework for non-life insurance activities, which basically works on the accumulation of annual premiums.

Meanwhile, EU DGSs’ environment is more and more distant from this general framework. Not even considering big numbers law, size of populations and events frequency:

* in order to fill a gap of funding or to rebuild their resources, DGSs can (and actually are asked to by DGSD2) raise ex post contributions across their membership – with no possibility for those members to escape the levy. Such a possibility is of course beyond the capacity of any traditional insurer;
* in the usual insurance business, competition offers a natural limit to premium accumulation. In the case of deposit insurance, with the support of SRM mechanism for large crises, such a limit should be exogenous and designed from the beginning – otherwise accumulation of premiums could go forever.
1. **The draft guidelines, prolonged after the resources building phase, would lead to adverse effects; this should invite for reconsidering the calculation of contributions both for the building and the stabilization phases.**

If the formulations for contributions proposed by the draft guidelines are prolonged after the building phase, that lead DGSs, after they passed the target level, to raise contributions on the basis of an increase in the total amount of covered deposits (at the market place level).

As a consequence, an increase in covered deposits for just one institution mainly leads all other institutions to pay additional contributions. All the same, a newcomer’s entrance on the market does not induce any requirement that this newcomer catches up with the resources building efforts carried by all others.

This could be further illustrated with the following – non theoretical – example: after a DGS has entered a phase where it only raises insignificant contributions, a given institution which has paid limited premiums until now, starts running a new and risky policy; it captures a growing part of the deposit base; then fails and triggers a massive payout. Of course, all the costs are going to be borne by those institutions which happened to have large deposit bases or high risk factors in the past, while the failed institution will have not contributed to the resources, nor will have been discouraged in its policy by the premium mechanism.

This echoes another issue. When building its resources base, a DGS has to make a decision between, on one hand, a large, conservative ex ante funding beyond the target level, and, on the other hand, a lighter ex ante funding, with ex post financing when needed. However, ex ante financing and ex post financing won’t weigh the same way on individual institutions because of the fluctuations of their risk factors and deposit bases, not mentioning the membership itself. Within the draft guidelines, the burden sharing within the membership for a given failure varies, depending on the moment the DGS decides to raise contributions.

As a general observation, managing the level of resources for a Banking Union DGS after it reaches its target level, raises a specific and new issue in the current framework: how will the evolutions of the banking sector (risks, deposit sharing, new licenses, failures…) be taken into account in the resources of the DGS and how could every institution still be properly incentivised?

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*On those bases, it seems desirable that the contribution formula proposed by the draft guidelines could be considered again so as to include, at least on an optional basis for Member States:*

* *the anticipation of a possible stabilization of DGSs resources level;*
* *an appropriate incentivization of institutions in their risk policies after the target level is reached;*
* *continuity of the formulas along the life of DGSs, whatever the phase or the initial level of their resources.*
1. EBA’s formulation for contributions [ $C\_{n}=CR\_{n}×ARW\_{n}×CD\_{n}×μ\_{n} $] directly derives, when using the same notations, from a non-life insurance business formulation:[ $C\_{n}=CR×ARW\_{n}×CD\_{n}$]. [↑](#footnote-ref-1)