Guidelines on payment commitments to Deposit guarantee schemes

New DGS Directive

- Published 12.06.2014.
- Transposition: 3.07.2015
  - Emergency payout: 31.05.2016
  - Risk based: can be postponed until 31.05.2016
  - Full phase-in of 7 working days repayment deadline: 31.12.2023
- EBA:
  - Financing:
    - Informed of level of ex ante financing
    - **GUIDELINES (GL) ON PAYMENT COMMITMENTS - 10(3) DGSD**
        - Informed of DGS own risk based methods
        - Report on calculation models 2019,
  - Home host
    - Informed of inter-DGS borrowing 12(1)
    - Informed of and mediates on intra EU cooperation agreements
- Other monitoring:
  - Collects information on cov. dep. from MS by 31 March each year
  - Peer reviews on stress tests every 5 years
Timeline for these Guidelines

- CONSULT: .. 2/01/2015
- ADOPT: May 2015
- COMPLY or EXPLAIN: End 2015 (tbd)
- REVIEW
Addressees of Guidelines

- Designated authorities (Public DGS / supervisor of private DGS)
- Competent authorities (banking supervisor)
- Resolution authorities
## Payment commitments = ex ante funding

| Ex ante (0.5-0.8%) | • Cash (min 70%)  
|                   | • **Payment Commitments** |
| Ex post (0.5%)    | • Cash |
| Alternative funding means | • Loans other DGS  
|                    | • Loans third parties (CB etc) |
Objectives

- Readily available funding
- Avoid procyclicality
- Level playing field
Content of the guidelines

1. Who implements the option
2. Components of Payment commitment arrangements
3. Financial collateral arrangements
4. Delivery of collateral
5-6. Eligibility of collateral
7. Valuation of collateral and haircut
8. Neutrality of prudential treatment
1. Who implements the option?

- Member State: transposes DGS power to accept PC
- DGS/DA implements option
  - No more than 30% of overall ex ante funding
  - No more than 30% per bank
  - Non discriminatory criteria
- Institutions opt in (or not)

Question 1

→ Criteria for overall amount of PC accepted by DGS?
→ Criteria to be applied to individual banks?
2. Components of Payment Co. Arrangements

- Separate regular contracts or governed by master agreement
- Payment Commitment Amount
- Irrevocable obligation upon simple and unconditional request
- Pay within 2 working days (1 if early intervention / crisis management)
- Communication of relevant events (e.g. insolvency, downgrade, deterioration in value…)
- Financial collateral arrangement

Questions 2 and 3
- Other components?
- Payment deadline?
3. Financial collateral arrangement - common

- Post collateral to secure payment commitment
- Replace if collateral falls due or is no longer eligible
- Top-up if collateral depreciates
- Enforcement events → acceleration of commitment / realisation or disposal
  - Fail to replace
  - Fail to top-up
  - Authorisation withdrawn
  - Bank no longer a member
  - Reorganisation or winding-up
- Return of collateral upon cash payment
3. Financial collateral arrangement – 2 options

- **Option 1 - Security Financial Collateral Arrangement:**
  - BANK
  - **Collateral (pledged)**
  - DGS

- **Option 2 - Title Transfer Financial Collateral Arrangement:**
  - BANK
  - **Collateral (pledged)**
  - DGS
  - **Collateral**

**Question 4**

→ Agree on option? Pros and cons?
4. Collateral Delivery

- **Common features**
  - Credited to ad hoc account held by DGS (for discussion)
  - Bank has no right to use or dispose
  - Custodian unable to dispose of the asset, no right of pledge or retention

- **Specificities:**
  - Securities Financial Collateral Arrangement (Option 1):
    - Bank has right to yields (if provided)
    - Enhanced custody requirements (identified by DA/DGS, fully segregates, and able to provide complete, accurate, up to date information)
  - Title transfer (Option 2):
    - DGS has right to use and dispose, and right to yield
    - Possibility of cash deposit with the DGS (if empowered)

**Question 5**

→ Industry view on custody? Other requirements?
5-6. Collateral Eligibility

- Low risk assets unencumbered by any third-party rights
  - Art, 336 CRR or “similarly safe and liquid” (0-20-50%)

- Implementation by DGS / DAs
  - Limit credit, market, liquidity risk
  - Diversification
    - Bank’s collateral: issuer, maturity, etc.
    - Proportionate approach for small banks if overall diversification
  - Limit highly correlated debt
    - E.g.: banks’ own debt
    - Currency risk discarded for that purpose

Questions 6, 7, 8, 9:
  - Suggestions on requirements
  - Role of currency in correlation analysis
  - Application of the proportionality principle
7. Collateral valuation and haircut

- Marked to market: currently observed change in value
- Haircut: caters for risk of change in value
  - Credit, market, liquidity risk
  - Issuer, maturity, currency
- Top-up if necessary
- Indicative: use ECB / NCB schedules and methodologies

Question 10

→ ECB / central bank methodologies?
7. Collateral valuation and haircut (2)

Guidelines on payment commitments to Deposit guarantee schemes
8. Ensuring prudential neutrality

<table>
<thead>
<tr>
<th>Account Type</th>
<th>Accounting Treatment</th>
<th>Prudential Treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td>P&amp;L</td>
<td>BS or off-BS</td>
<td></td>
</tr>
<tr>
<td>Cash contribution</td>
<td>Expense</td>
<td>A: ↓cash E: ↓ret. earnings</td>
</tr>
<tr>
<td>Payment commitment</td>
<td>1. Expense recognised</td>
<td>L: ↑provision E: ↓ret. earnings</td>
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<tr>
<td></td>
<td></td>
<td>A: ↓fin. instrmts E: ↓ret. earnings</td>
</tr>
<tr>
<td></td>
<td>2. No expense recognised</td>
<td>off BS (contingent liability)</td>
</tr>
</tbody>
</table>

Question 11: → Agree on objective? Analysis? → Further prescriptions?
Questions