

Comments

EBA Report on the appropriate target level basis for resolution financing arrangements under Bank Recovery and Resolution Directive (EBA/CP/2016/08)

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I. General remarks

- We welcome in principle the report's overriding objective of finding a basis for calculating a target level for resolution funds that is as non-volatile as possible. Evenly staggered contributions during the build-up phase of funds are also in the interest of the contributing institutions, which depend on reliable data for their financial planning.
- In view of the late national implementation of the BRRD in some cases, it appears too early to assess the impact of Article 102 of the BRRD in practice in order to identify any need for regulatory action. Given the constant level of covered deposits, and to avoid any intransparency, legal/planning uncertainty and – especially also in regard to the Single Resolution Fund (SRF) – distortion of competition, we believe that turning the target level basis away from covered deposits must be avoided.
- The minimum required target level for resolution funds set in the BRRD and the ex-ante contributions to be made by institutions in this context are designed to ensure that, before instigating resolution measures, national resolution funds have enough financial resources at their disposal to cover any costs and losses caused by the resolution measures. The level of resources that resolution funds need in order to be able to act in a crisis depends, in our view, particularly on the respective national banking market and can only be roughly estimated at present. With the use of bail-in as a resolution tool in mind, we believe that gearing the target level basis to covered deposits is appropriate, as basically all liabilities – with the exception of the liabilities (including covered deposits) explicitly excluded under Article 44 (2) of the BRRD – may be included in bail-in proceedings and would thus precisely not have to be secured by financial resources available to resolution funds. It would therefore not be right, in our view, to broaden the target level basis to include such liabilities as well.
- Any changes to the target level basis should not be accompanied by an increase in the minimum target level for national resolution funds. Any additional burden on institutions in the form of higher contributions must be rejected. We thus share the view expressed by the EBA in paragraph 7 of the report that the overall level of contributions to resolution funds should be constant, irrespective of the underlying target level basis. Any – in our view, uncalled for – legislative proposal by the European Commission to alter this basis would therefore have to contain a correspondingly revenue-neutral target ratio for the new basis. For illustrative purposes, a rough estimate of the overall amount to be raised under a 1% target level for the SRF based on the three options outlined by the EBA would result in a least a doubling, and up to four times as much.
- With this in mind, we believe that finding a new target level basis for the BRRD similar to the current one of at least *"1% of the amount of covered deposits of all the institutions authorised in a given Member State's territory"* that applies uniformly in all Member States and does not lead to higher contributions for any contributing institution is, however, difficult, if not virtually impossible. The appropriateness of covered deposits as the target level basis cannot be assessed separately from a ratio. This is confirmed by the EBA in paragraph 7: *"[...] if the target basis was to change from covered deposits*

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to total liabilities, keeping the target level at 1% would significantly increase contributions to the resolution financing arrangement."

- In our view, the EBA should therefore not only recommend a new target level basis but also examine at the same time whether the new basis, including a uniform ratio in all Member States, serves to preserve the status quo as regards the minimum target level for national resolution funds. We believe that a quantitative impact analysis based on current figures is essential for this purpose.

II. Different target level basis between the BRRD and the SRF

- We believe that a quantitative impact analysis is imperative to assess the implications of any changes to the SRF target level basis.
- It is correct that, under Article 94 of Regulation (EU) No 806/2014 (SRM Regulation), the mandate regarding the SRF target level basis will only follow at the end of 2018. The SRF applies to most Member States, however, so that we would argue that the EBA should take into account any inconsistencies between the BRRD and the SRF arising from the current report.
- Changing solely the BRRD basis, while potentially keeping the SRF basis, would be detrimental mainly for two reasons:
 1. The collection of contributions would become much more complex than necessary.
 2. During the build-up phase until 2023, contributions from SRF institutions are based on both the BRRD and the SRF (Council Implementing Regulation (EU) 2015/81). So, while it is perhaps correct that the overall target level can be kept constant by changing the target percentage, SRF banks could still be faced with shifts in distribution across countries, potentially distorting competition.
- The decision to create an SRM and an SRF for the euro area countries by way of the SRM Regulation was preceded by lengthy, intensive negotiations at political level. In addition, Member States agreed to conclude an Intergovernmental Agreement (IGA) with regard to the SRF. As the EBA explains, there is no room for differentiation in the burden on institutions, e.g. at individual Member State level. *"The systematic context of the Intergovernmental Agreement and Articles 69 to 71 make clear that a shifting of the burden from institutions in one Member State to those in another Member State is not possible."*¹ A level playing field for all institutions needs to be ensured at SRF level.

¹ EBA/Op/2015/11: *Technical advice on the delegated acts on the initial period of the Single Resolution Fund under Article 69 of the SRM Regulation*, p. 5.

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- Should the Commission decide on the basis of the EBA report to alter the target level basis and not to keep covered deposits, we believe that, in order to avoid any intransparency, legal/planning uncertainty and distortion of competition, this must be done simultaneously in the BRRD and the SRM Regulation (as proposed in paragraph 8). In this context, it should also be examined whether the adjustment method under Article 8 of Implementing Regulation 2015/81 is still appropriate. The chosen adjustment method (phase-in) during the SRF build-up phase should apply the principle of proportionality and avoid any distortion between Member State banking sectors. As covered deposits were taken as the basis for phase-in, the impact on phase-in in the event of any changes to this basis would have to be taken into account.

III. Specific remarks

Question 1: *Do you think the report is missing any crucial criteria or arguments in favour of or against a particular option?*

Availability of data

- The report does not, in our view, sufficiently consider and recognise when the relevant metrics are available.
- Delegated Regulation (EU) No 2015/63 of 21 October 2014 supplements the BRRD by setting out the arrangements for the collection of contributions for resolution funds. In order to fix the annual contributions by 1 May of any year at the latest, the resolution authorities set the target level. This is currently based on the covered deposits of the preceding year, which the deposit guarantee schemes are required to determine and report by no later than 31 January. The metric for calculating the target level is therefore available to the resolution authorities within one month after the relevant cut-off date.
- Should the basis for calculation be changed – to the “total liabilities” metric, for example – this sequence of steps cannot be adhered to in practice. In this case, institutions need more time to complete preparation of their annual financial statements and, if necessary, to make any additional manual calculations to cancel out accounting differences. Calculation of the target level for the contributions for a year can thus no longer be performed on the basis of data for the preceding year but only on the basis of data for the year before that. This time lag in calculation of the target level is inappropriate, in our view.
- At the EBA hearing on 16 August 2016, the EBA countered this argument by stating that in some Member States data on covered deposits cannot be delivered in time, so that data for the year before the preceding year already has to be used in these cases. This argument does not stand up, in our view. Where individual Member States fail to apply directly applicable EU Regulations in full or on schedule, this cannot be allowed to result

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in legislation being abolished or amended. Instead, efforts should be made to ensure that legislation is implemented equally in all Member States.

Correlation of the basis for calculation with State aid approved

- The EBA cites as the main reason for the proposed change that the level of deposits correlates less with the level of State aid than with the other bases for calculation proposed by the EBA. This is shown in Table 1 in paragraph 28, and the significance of this correlation cannot be denied.
- However, the development of the different bases for assessing how constant metrics are over time, presented in paragraph 30 (chart 1) is, in our view, not recognised sufficiently in the further EBA analysis.
- A look at correlations between State aid and different bases for calculating the EU bank levy shows that deposits display the lowest correlation with State aid. Yet altering the basis for calculation would – at least during the transition phase – imply distribution effects: institutions in countries with a low proportion of covered deposits to aggregated deposits could benefit from a changed basis for calculation (e.g. total liabilities) if these institutions' proportion of total liabilities to aggregated total liabilities is higher. Any change to the basis for calculation could mean a higher burden for retail banks, which – as shown in the correlations chart – have used less State aid. For these reasons, a quantitative impact analysis is essential before any change is made to the basis for calculating the EU bank levy.
- The message of chart 1 in paragraph 30 is that the only constant metric in recent years has been deposits, so that only this metric leads to a constant target level. The other metrics would lead to higher target level volatility that would then have to be offset by adjusting the annual distribution rates. In view of the fact that paragraph 7 says that the target level should remain constant, the evaluation criteria "*Dynamic and smoothness of contributions*" and "*Simplicity and transparency*" should be assigned more importance or more weight in further analysis.

Option 2: Total liabilities/differences in accounting

- The report rightly says that, because of different accounting rules, the term "*total liabilities*" is not a harmonised definition. The existing differences between national GAAP and IFRS within Member States are, in our view, so substantial that no level playing field could be ensured for calculation of the target level.
- The differences in accounting are, in our view, a considerable obstacle to harmonised requirements. The EBA draws attention to this problem in its *Report* – starting at the page 33 - *on Implementation and Design of the MREL Framework (EBA/Op/2016/12)*, published on 19 July 2016. In principle, both national accounting rules (in Germany, the Commercial Code (HGB)) and international accounting rules (IFRS) serve to make a company's financial situation transparent. There are, however, serious differences when

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it comes to valuation methods and many points of detail. In our view, these can only be partly offset through adjustment.

- When calculating individual contributions for institutions, total liabilities are the starting point for determining the volume of contributions. To offset differences in accounting – particularly when it comes to the inclusion of derivatives – comprehensive, complex revaluation is, however, required. Should – as proposed by the EBA – total liabilities be taken as the new target level basis, such complex revaluation would be additionally required from all institutions also for calculating the target level. We reject this. This means failure to achieve the aim of having a simple and transparent metric.
- The data that would have to be used to ensure a level playing field for the target level for resolution funds is thus not the generally available and published data on total liabilities. Instead, adjustments of this data to offset differences in accounting would be needed solely for calculating the target level. Though these have not yet been specified in detail, it can be assumed in view of the experience made with adjustment of derivatives to calculate individual contributions that they will be complex and time-consuming. We believe this is inappropriate, given that the adjustments are not in principle to be accompanied by any changes to the overall target level.
- In our view, the EBA's assessment of the three options based on total liabilities in the *"Summary of options for the target level basis"* is thus incorrect. As regards the criterion "Simplicity and transparency", the EBA's [++] should be replaced by [-]. The positive assessment of the criterion *"Consistency with the contributions methodology"* is incorrect since, in particular, small institutions subject to flat-rate contributions do not, due to their flat-rate contribution burden, have to adjust their data because of accounting rules. Should total liabilities be used as the target level basis, however, these institutions would be additionally burdened.

Extent to which metrics can be influenced by institutions

- In our view, the qualitative assessment of the possible options/metrics for the target level basis fails to take adequate account of the extent to which the metrics can be influenced by institutions.
- We believe that the level of contributions to the resolution funds creates incentives for institutions to design the relevant individual metrics for collection of contributions in such a way that they have as small an ex-ante contribution burden as possible. This is in principle understandable and in no way reprehensible. However, the target level basis should be exposed to as little influence as possible from institutions. Otherwise the result may be more volatile.
- As already explained above, various valuation rules provide a number of ways of calculating the "total liabilities" metric as low as possible. As total liabilities is, in addition, the starting point for individual calculation of contributions, there would be a double incentive for optimising it (basis for calculating the target level and individual contributions).

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- By contrast, "covered deposits" is, in our view, a transparent and practicable metric that is largely uninfluenced by possible valuation measures. Institutions could merely optimise it in the medium to long term within the scope of a change to their business model. In addition, covered deposits are a deductible item in calculation of individual institution contributions, so that there is little incentive to calculate this metric as low as possible.

Question 2: Do you have a preference for one of the following recommended options?:

- (a) total liabilities (including own funds),
- (b) total liabilities excluding own funds
- (c) total liabilities excluding own funds less covered deposits

- Given the constant level of covered deposits, and to avoid intransparency, legal/planning uncertainty and distortion of competition, we reject any change to the target level basis.
- An assessment of the options in question calls for a quantitative impact analysis that would also have to examine the impact on the SRF.

Question 3: *Is there any other option which would be preferable to those in the recommendation? Please provide the rationale supporting your view.*

- As the EBA points out in paragraph 24, there is currently no reliable basis for estimating future funding needs for any resolution measures.
- With this in mind, and in view of the above-mentioned challenges if the target level basis is altered, a change would not be appropriate. We would therefore strongly recommend keeping covered deposits as the basis.