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European Banking Authority
Floor 46
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(submitted via EBA website)

Re: CONSULTATION PAPER (EBA/CP/2014/35)
Draft Guidelines on methods for calculating contributions to Deposit Guarantee Schemes

Introduction

BNY Mellon is a global custody and trust company dedicated to helping its clients manage and service their financial assets throughout the investment lifecycle. As one of the world's largest investment services and investment management firms, BNY Mellon welcomes the opportunity to respond to the EBA Consultation Paper (*EBA/CP/2014/35*) in respect of Draft Guidelines on methods for calculating contributions to deposit guarantee schemes.

BNY Mellon operates in Europe through: (i) branches of The Bank of New York Mellon (a New York incorporated financial institution) and (ii) directly established and duly authorised subsidiaries established in several EU jurisdictions and branches of those entities operating in most of the core EU member states. It provides services to clients and end-users of financial services globally. It is accordingly keenly interested to ensure financial markets operate fairly and consistently globally and that common standards ensure playing fields are kept level.

Executive Summary

BNY Mellon supports risk-based contributions, and in our view the risk indicators should factor risk-sensitive measures into the indicators.

In regard to minimum contribution amounts, BNY Mellon discourages their use. Where they are to be used, BNY Mellon recommends that minimum contributions are paid **in addition to** risk-based contributions. The primary purpose of such minimum contributions should be to cover the operating costs and expenses of the Deposit Guarantee Scheme rather than the funds that the DGS would pay out to depositors. We expand on this in our answer to Question 1 below.

In regard to the core risk indicators, our view is that CET1 ratio or capital coverage ratio should be preferred rather than the leverage ratio. We think the CET1 ratio is more effective than the leverage ratio because the leverage ratio is not, and is not intended to be, risk-sensitive. We expand on this in our answers to Question 5 below.

<u>Question 1 – Do you have any general comments on the draft Guidelines on methods for calculating contributions to DGSs?</u>

BNY Mellon is broadly supportive of the EBA's proposals in this Consultation Paper. BNY Mellon agrees with the requirement in Article 13(1) of the Deposit Guarantee Scheme Directive ("DGSD"), for contributions to deposit guarantee schemes to be "*based on the amount of covered deposits and the degree of risk incurred by the respective member*". We are broadly supportive of the EBA draft guidelines in this respect.

However, BNY Mellon wishes to comment on the **minimum contribution amounts** (as referred to in Part IV of the Consultation Paper). We note that under Article 13(1) of the DGSD, Member States may decide that credit institutions should pay a minimum contribution "*irrespective of the amount of their covered deposits*" (or indeed, the risk profile of the institution).

The Consultation Paper sets out two approaches to minimum contribution amounts:

- A minimum contribution to be paid **in addition to** a risk-based contributions;

- A minimum contribution to be paid **instead of** a risk-based contribution, where the risk-based contribution would be lower than the minimum contribution (as determined).

BNY Mellon's view is that minimum contribution amounts should be discouraged, because minimum or fixed contributions do not (in our view) adequately take into account the risk profile of the institution, and could lead to moral hazard as referred to in pages 5 and 29 of the Consultation Paper. Minimum contributions may also create barriers to entry, as referred to in page 29 of the Consultation Paper, particularly for smaller institutions and the "challenger banks" or start-up institutions.

Our view is that, to the extent a minimum contribution amount should be permitted, that the first option is preferable (a minimum contribution **in addition to** the risk-based contribution). This places primacy on the risk profile of the institution (and the amount of covered deposits), and *all* institutions will need to consider the impact of risk on the amount of their contribution to deposit guarantee schemes. This approach also enables the risk-based contribution to constitute the major part of the total contribution for all but the smallest firms.

The second option in our view creates barriers to entry for smaller institutions / challenger banks, and in particular the smallest institutions and start-ups. Furthermore, the second option may create moral hazard in respect of the range of institutions that pay the minimum amount (rather than the risk-based contribution). This is because the calculation methodology does not incentivise institutions to manage risk, until such point as the institution would exceed the minimum.

As a practical suggestion, BNY Mellon recommends that where a minimum contribution amount is to be used:

- The first option is used (i.e., a minimum contribution **in addition to** risk-based contributions); and
- In this case, the purpose of the minimum additional contribution should primarily be to cover the operating costs and expenses of the body administering the Deposit Guarantee Scheme ("DGS"), rather than to cover the actual funds that the DGS

would pay out to covered depositors (i.e., the funds constituting the target level of 0.8% of covered deposits).

We believe that using minimum contributions to fund (at least in part) the operating costs and expenses of the administering body of the DGS is preferable, because these are relatively fixed costs that do not vary according to the risk profile of the in-scope institutions.

The administering body of the DGS will in any event need to be in contact with every in-scope institution - for example, to maintain contact details, to obtain regular reports and updates, and to conduct evaluations and reviews. Even if an institution has a very small amount of covered deposits and it is very low risk, the administering body would still need to perform these functions. Therefore, it is easier to justify that every in-scope institution should make a minimum contribution towards these operating costs and expenses.

Question 5 – Do you agree with the core risk indicators proposed in these Guidelines? If not, please specify your reasons and suggest alternative indicators that can be applied to institutions in all Member States. Do you foresee any unintended consequences that could stem from the suggested indicators?

BNY Mellon supports risk-based contributions. Banks have different business models and different risk profiles, which contribute to diversification and specialisation in the financial services sector to the benefit of customers and shareholders. Regulations should be tailored accordingly to these risks. In this regard, we believe that the risk indicators should factor risk-sensitive measures into the indicators. As an example, the risk-weighted assets to total assets ratio is an appropriate indicator, as it explicitly factors in the risk-weighting of assets into the ratio.

In regard to the capital indicators, BNY Mellon's view is that the CET1 ratio or capital coverage ratio should be preferred, rather than the leverage ratio, because the leverage ratio is not, and is not intended to be, risk-sensitive.

As indicated in the Consultation Paper, capital indicators reflect the level of loss absorbing capacity of the institution. Higher amounts of capital held by the institution indicate that it has better ability to absorb losses internally, thus decreasing its likelihood of failure.

Given the intention of DGSD to have risk-based contributions, it is more appropriate in our view for the risk-weighting of assets to be taken into account for the purposes of the capital indicator.

If the EBA believes that the leverage ratio should still feature as a risk indicator (i.e., to have more than one capital indicator), we would recommend that the minimum weight of the leverage ratio is reduced, and the minimum weight of the CET1 ratio or capital coverage ratio is increased accordingly, so that more emphasis is given to the risk-weighted assets in the context of the capital indicator.

BNY Mellon looks forward to further engagement with the EBA in regard to this Consultation Paper and other consultation papers relating to BRRD and DGSD.

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