

Regulatory Flash

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Economic Analysis

Recovery & Resolution
Policy

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Agreement reached on DGS Directive

After three years of stop-start negotiations, yesterday the Council approved a political agreement reached with the European Parliament, representing an important step towards completing the crisis management framework for banks in the EU. This new directive will strengthen the existing system of national DGS, maintaining harmonized coverage of a minimum € 100.000 in case of bankruptcy and with an easier and faster access to the guaranteed amount. A quite robust financing regime is established, which increases the confidence on DGS capacity to withstand several scenarios of banking crisis without the recourse to taxpayers. After formal approval by co-legislators, national transposition will be done within one year. The most important developments of this Directive are the following:

1. Shorter repayment period

- **Repayment deadlines will be gradually reduced from current 20 to 7 working days** by 2024. In the meantime, the maximum delay is set in 15 days, as from 1 January 2019, and 10 days as from 1 January 2021. In order to ensure that depositors do not encounter financial difficulties on request they will have a quick access to their covered deposits to cover the cost of living.
- The shorter period is aligned with the liquidity requirement, in line with the revision of Liquidity Coverage Ratio (LCR) of Basel III in January 2013¹.

2. A new robust financing regime

This Directive harmonizes and strengthens the financing requirements for DGS, with a significant level of ex-ante funding to be collected from banks, in order to ensure that each scheme has "enough" funds in place to deal with a medium-size bank failure. With this aim, financing is based as follows:

1. **Ex-ante funding:** In a period no longer than 10 years, the DGS must reach at least a target level of 0.8% of covered deposits. In special circumstances the period may be extended up to 4 years. Additionally, the Commission may authorize a Member State with a highly concentrated banking sector to set a lower target level (no less than 0.5%).
2. **Ex-post funding:** Entities must pay an extraordinary financing not exceeding 0.5% (except in exceptional circumstances) of their covered deposits per calendar year.
3. **DGS borrowing:** Member States may allow DGS to lend to other schemes within the EU on a voluntary basis.
4. **Alternative funds:** As a last resort, the DGS must have in place alternative funding arrangements to obtain short-term funding where necessary.
5. **Contributions to DGS:** The contributions to DGS shall be based on the amount of covered deposits and the degree of risk incurred by the respective member. Thus, the Member States may provide for lower contributions for lower-risk sectors which are governed by national law.
 - **DGS may use their own risk-based methods for determining and calculating the risk-based contributions by their members.** The calculation of contributions shall be proportional to the risk of the members and shall take account the risk profiles of the various business models. This method may also take into account the asset side of the balance sheet and risk indicators, such as capital adequacy, asset quality and liquidity
 - Each **method shall be approved by the competent authority** in cooperation with designated authority. EBA shall be informed about the methods approved. In the following months EBA will issue to specify methods for calculating the contributions to DGS.

¹ Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools, January 2013

3. Use of funds in resolution and in early intervention

Besides its primary role as a safety net for bank account holders in case of a bank failure (repay depositors), a scheme's funds can be used for resolution purposes, when authorities decide the activation of the **resolution** procedure to avoid the systemic consequences of a bank's failure.

- **Use in early intervention:** Member States may allow DGS to use its funds for alternative measures (early intervention) in order to prevent bank failure, provided that certain conditions are met.
- **Use in resolution:** DGS may be called to contribute to resolution, according to Article 99 of the new Bank Recovery and Resolution Directive (BRRD). The resolution authority will decide, in consultation with the DGS, the amount by which the DGS is liable to be used in resolution. The BRRD stipulates that, where the resolution authorities take resolution action, and provided that this action ensures that depositors continue to have access to their deposits, the relevant DGS shall be liable for the amount of losses that covered depositors would have suffered if they were not excluded from bail-in.

If available financial means of the DGS are used and subsequently are reduced to less than two thirds of the target level, the regular contribution to DGS shall be set at a level such that allow for reaching the target level within six years.

In all cases, the liability of the DGS shall not be greater than the amount equal to 50% of the target funding level prescribed for the DGS under applicable Union law, however, Member States have the ability to set a higher cap of 50%. In any circumstances, the deposit guarantee scheme's participation under BRRD shall not exceed the losses it would have incurred in a winding up under normal insolvency proceedings.

Finally, the BRRD establishes that Member States may use the same administrative structure of their financing arrangement for the purpose of their deposit guarantee scheme. In any case, the final contribution will be 1.8% of total covered deposits (1% of the resolution fund contribution and 0.8% of the deposit guarantee scheme contribution).

4. Maintenance of a universal coverage of € 100 000

The new Directive preserves the harmonized minimum coverage level of € 100 000 per depositor and per bank set in 2010, offering protection to deposits held by individuals and companies outside the financial sector.

5. Entry into force and next steps

The Council is expected to adopt its position at first reading on the Directive in early March without further discussion, once the text has been finalized in all EU languages. The European Parliament is expected to acknowledge the Council's position in March and to adopt the directive at second reading at its plenary session in April.

The Directive will enter into force once it has been signed by both institutions and published in the Official Journal in the weeks following the April EP plenary session. The member states will have one year after entry into force to transpose it into national law. Thus, implementation of the Directive is expected by 2015.

6. Assessment

The agreement reached at the ECOFIN goes in the right direction towards reinforcing the Crisis Management Framework. However, there are pending issues that have to be finalized in order to align this Directive with Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM), specially the contribution to Resolution Fund.

- On the **positive side**, with this Directive the EU achieves: i) enhancement of the whole crisis management framework to the extent that covered depositors have a renewed framework which ultimately reinforces financial stability, ii)- a simplification and harmonization, in particular as to the scope of coverage and the arrangements for payout; iii)- further reduction of the time for paying out depositors and better access for DGS to information about their members and iv)- a credible DGSs that are sufficiently financed.
- On the **negative side**, The methodology of contributions to DGS is not clearly defined. Under the DGSD, contributions to DGS are required to be based on the amount of covered deposits and the degree of risk incurred by the bank. However, uncertainty remains as to how the risk adjustments should be conducted. In any case, there should be a consistent approach to risk adjustment of contributions under the BRRD and the SRM. Furthermore, there should be consistency between the risk adjustments for resolution funds and DGS (accepting that some differences might be necessary due to the different assessment base). Moreover, the trade-off between contributing to DGS and Resolution fund must be kept in mind, it seems logical that if a Member State authorizes a lower target funding level for their DGS, at the same time it should set a higher limit for the DGS liability in resolution.

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