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FRENCH BANKING FEDERATION DRAFT RESPONSE TO EBA CONSULTATION ON PAYMENT COMMTMENTS (PC) CP/2014/27

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorized as banks and doing business in France, i.e. more than 390 commercial, cooperative and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 370,000 people in France and around the world, and service 48 million customers.

General comments

French banks understand that the EBA quest for harmonization has led it to propose detailed guidelines that may go beyond the intention of European co-legislators. They welcome the introduction of payment commitments amongst the financial Deposit Guarantee Schemes (DGS) financial resources, yet they are wary of the serious drawbacks that EBA proposed provisions may entail.

As the EBA is not in charge of accounting regulation, it rightly considers different options depending on the way payment commitments are classified under applicable accounting rules; the proposed conditions however render these options void. Accounting experts and auditors consider that payment commitments, as currently required by the proposed guidelines, will force banks to recognise these payments in the profit and loss account. Moreover if the prudential treatment proposed by the EBA is to apply an ad hoc approach to ensure equivalence with cash payments, there is a clear disincentive in using payment commitments. We therefore conclude that this was not the intention of the European legislators and that the EBA should revise its proposed guidelines.

Accounting treatment

We would like to ask for a revision of proposed guidelines in order to clarify that a payment by a credit institution can only be required following a pre-defined default event introducing a contingency upon a future determinable event for which the likelihood of its occurrence can be assessed. As each payment commitment is guaranteed by pledged securities, the proposed amendment would not result in an increase of funding risk for the DGS and will still be in line with the DGS2 Directive's objectives. We suggest defining the event as follows in Part 2 paragraph 11 b):

> *b) The irrevocable obligation for the credit institution to make the promised cash payment of the Payment Commitment Amount following a predefined default event, similar to a financial guarantee in order to assure that payment commitments are accounted for as off-balance sheet contingencies ~~time, upon simple and unconditional request of the DGS, without undue delay and at any rate no later than 2 working days from the receipt of the notice pursuant to letter (c) below.~~ Such payment period is done into a 1 working day in case early intervention or crisis management measures are applied on the credit institution by the competent or resolution authority. The arrangement should preclude any reduction in the Payment Commitment Amount, or any termination of the Payment Commitment Arrangement, without the consent of the DGS.*

In order to accommodate a more favourable accounting treatment we suggest the following changes to paragraph 12 d (iii-v):

- To add "reflecting a situation of a gone concern for the institution" at the end of paragraph 12d iii, 12div and 12d v or "following a predefined default event, similar to a financial guarantee. In this case, the payment obligation would be contingent upon a future event that is determinable and for which the likelihood of its occurrence can be assessed."
- In addition, we suggest a revision to clarify that the existence of a payment commitment is linked to the inclusion of the credit institution in the scope of the respective DGS. The payment commitment would therefore terminate without settlement when the credit institution does no longer have any deposits covered by the respective DGS. The payment commitment recorded by the institution among its off-balance sheet commitments would then be reduced or even withdrawn and the collateral backing these commitments returned to the institution.

We would like to point out that an approach reflecting this rationale was recently endorsed by the European Commission in the context of contributions to the Single Resolution Fund (SRF), whereby as a consequence of a change of status (e.g. the institution ceases to fall within the scope of the DGSD2) of an institution during the contribution period and during the subsequent periods, has no effect on the annual contribution to be paid in that particular year while the institution ceases to owe its contribution for the subsequent periods.

We suggest amending paragraph 12 e as follows:

> *In case of (i) authorisation withdrawn and (ii) the institution ceasing to be member of DGS - other than reflecting a gone concern situation - the commitment is re-allocated to the other members of DGS, proportionally to their share of covered deposits on total deposits.* ***The payment commitment of the institution is cancelled and the collateral backing this commitment is returned.***

In this context, the requirement to annually amend or supplement payment commitments should be clarified to allow for adjustment to reflect the actual current exposure contribution of a credit institution. In other words, the payment commitment can be reduced or even terminated given that this is in line with the contribution of the credit institution to the overall exposure of the DGS.

We suggest that the proposed guidelines specify that cash deposits bear interests. The payment of interests on cash deposits will ensure that cash deposits are not expenses but accounted as assets as defined under the IFRS Conceptual framework [§4.4 (a)].

Prudential treatment

We do not agree with the provisions of the paragraph 30, Part 8. Indeed, the paragraph requires that that prudential impact shall be the same for cash payments and payment commitments. On the contrary, we think that the prudential treatment should reflect the risk of the commitment and shall be assessed to this end. Furthermore accounting treatments are driven by economic and legal characteristics of the commitment, so having different prudential impacts for different accounting categories is rational and consistent. Furthermore, the CRR provisions are quite precise and prescriptive concerning the required prudential treatment that should be applied to off balance sheet commitments.

However, we agree that the competent authorities should assess, as it is usually done for all other kinds of risks, within the supervisory review and evaluation process (SREP) the risks to which the capital and liquidity positions of the credit institution would be exposed should the DGS be called upon it to pay the commitment.

The prudential treatment should reflect this assessment.

As DGS remain national, the treatment should reflect the probability that the DGS is called upon and the potential losses stemming from a DGS intervention, on a net basis after potential recoveries from the bankruptcy estate of the failed institution.

The contributions of the DGS to resolution are limited to the lesser of a) the amount of losses covered depositors would have borne in insolvency, or b) 50% (or a higher percentage set by the member state) of the target level of the deposit guarantee fund. Moreover DGS subrogating to the rights and obligations of covered depositors in insolvency have the same priority ranking which is higher than the ranking provided for the claims of ordinary unsecured, non-preferred creditors.

Generally speaking DGS commitment payments represent only a small part of the own funds requirements (2 or 3 %) or of the liquidity assets and when they are called they won't jeopardize the capital and liquidity position of a bank.

These two elements should be assessed by the designated authority on a national basis and risk-weighted accordingly.

As a measure of simplification, we propose the payment commitments to be risk-weighted as an unrated institution under the standardized approach (i.e. 100%) with a credit conversion factor of 20%, which would be quite conservative given the low probability that the payment commitment is called.