

Fonds de Garantie des Dépôts – FRANCE

FSB Consultation on Effective Resolution of Systemically Important Financial Institutions

Discussion note on creditor hierarchy, depositor preference and depositor protection in resolution

Contribution from Fonds de Garantie des Dépôts (French Deposit Guarantee Scheme)

Fonds de Garantie des Dépôts (FGD) welcomes the Financial Stability Board consultation and the opportunity to share its views on the issue of depositor preference, recently raised by FSB.

Important differences remain between national laws worldwide, as indicated in FSB note, not just for depositors ranking in creditors hierarchy itself, but in many other aspects of the various laws involved in the liquidation or resolution process of a failing bank, whereas deposits themselves are not even internationally harmonized in their definitions. Harmonizing depositors ranking internationally in this context, for the sake of an efficient cross border resolution, would actually require harmonizing national legislations in a much wider extent, which does not seem feasible or even desirable, without much deeper considerations and studies.

As such harmonization could strongly disturb bank financing, both in the interbank market and in the bond market, a well documented impact assessment would be also much needed. At this stage, should such a harmonization be envisaged, which looks neither necessary nor a priority, depositor preference does not appear as relevant. Eliminating preferences would be much more desirable.

FSB will find below answers to the questions opened for public consultation.

21. Does the existence of differences in statutory creditor rankings impede effective cross-border resolutions? If so, which differences, in particular, impede effective cross-border resolutions?

It is likely that differences in creditor rankings could in some way hinder effective cross-border resolutions for banks involved in cross-border activities.

However, this does not constitute the main issue: as long as a bank is to go bust, all creditors feel at risk, whatever the creditor hierarchy, especially if they fear that losses could exceed the volume of

equity and subordinated debt. The main goal should be, in all cases, to avoid threatening the senior debt and beyond. In such a context, creditor hierarchy is a minor element compared to core 1 and 2 ratios, legal powers of the Resolution Authority, financial resources of the Resolution Fund and the credibility of the process itself for the markets.

Besides this, legal differences between various debt issuances and jurisdictions go well beyond creditor hierarchy, be it contractual terms, procedures, legal delays, legal actions. Contract law, insolvency law, claims law should also be considered for further harmonization. Changing one specific element, creditor hierarchy in this case, hardly changes the global picture.

22. Is a greater convergence of the statutory ranking of creditors across jurisdictions desirable and feasible? Should convergence be in the direction of depositor preference or should it be in the direction of an elimination of preferences? Is a harmonized definition of deposits and insured deposits desirable and feasible?

a/ Again, any convergence could be considered as desirable on a theoretical point of view. But it seems unlikely that the convergence of the statutory ranking of creditors could have significant effects without a more comprehensive convergence of the various legal systems involved, not talking about a standardization of issuance contracts for instance.

b/ Depositor preference could facilitate the action of a resolution authority if this authority needs to carve out deposits and transfer them to a bridge bank, leaving other general creditors behind. But it is quite possible to solve this *pari passu* issue, as long as a guarantee is granted to these general creditors, for instance by a DGS/ Resolution Fund, that they won't be treated less favorably through a liquidation procedure, than if depositors would have shared that burden with them.

The implied costs for the DGS/ Resolution Fund would quite fairly echo what it would have needed otherwise to rescue depositors, and would probably diminish the amount of money that the DGS/ Resolution Fund would probably have to spend in other ways in such cases.

For these reasons, FGD does not see depositor preference as needed in such a deposit bridge bank scheme. As a whole, the benefits of depositor preference look quite limited to FGD.

c/ There is a more embarrassing element, which is directly linked to bank financing.

Any change of existing creditor rankings in a given jurisdiction would trigger unpredicted or undesirable consequences on creditors' behavior. That could especially be the case with other unsecured creditors if depositors were to get a higher position in the rankings. Other unsecured creditors would be next in line after subordinated debt holders and, given the usually huge amounts of deposits, would consider themselves as being not far of subordinated creditors.

Where they play an important role for bank financing, the interbank market as well as the market for general unsecured debt would then be at risk of being dried up, in favor of more secured segments (covered bonds, securitized debts), with no benefit for the stability of the financial sector.

d/ It is also right to stress that a harmonized depositor preference would require, to be effective, a harmonized definition of deposits (and of insured deposits if a difference had to be made in terms of

creditor hierarchy). The European Union efforts in this field show that even if some convergence could be possibly achieved (and thanks to a preexisting common background in financial regulation), the harmonization that would be supposedly required to enhance the effectiveness of a resolution process, is a long way to go. Besides this, even in the countries which provide with some forms of depositor preference, the scope and the extent of the preference, as well as the definition of covered deposits, differ.

For these various reasons, depositor ranking harmonization could not be considered as a priority. Would a harmonization be considered, the elimination of preferences would seem more advisable than the opposite.

23. Is there a risk of arbitrage in giving a preference to all depositors or should a possible preference be restricted to certain categories of depositors, e.g. retail deposits? What should be the treatment of (a) deposits from large corporates; (b) deposits from other financial firms, including banks, asset managers and hedge banks, insurers and pension funds; (c) the (subrogated) claims of the deposit guarantee schemes (especially in jurisdictions where these schemes are financed by the banking industry)?

One of the reasons why various DGSs do not guarantee financial institutions' deposits is because of the role of other (professional) financial institutions in monitoring the risks of the banks where they put their deposits. It makes much sense to FGD to preserve this role. In any case, the coverage limit of the guarantees usually forces financial institutions and large corporate to look beyond the guarantee offered by the DGS. All in all, this could urge for targeting a similar difference between retail deposits and others, in creditor rankings, with a higher rank for the former than for the latter. Then, to be effective in a cross border resolution, a harmonized depositor ranking should be harmonized also taking into account various depositor categories.

At the same time, instituting harmonized differences between depositors (retail/ corporate/ financial firms/ insured/ non insured) at a cross-border level, seems a rather difficult task and, again, should be put in balance with the possible benefits.

On both sides of the coin, this does not help, in FGD view, the case for a possible depositor preference.

FGD also believes that the creditor rankings of depositors and DGSs when subrogating their claims should be the same: a DGS role is to protect depositors and not necessarily to strip them from a bigger part (neither from a smaller part) of their uncovered deposits after the enforcement of the subrogation. Being financed by the banking industry does not affect in any way this point of view.

24. What are the costs and benefits that emerge from the depositor preference? Do the benefits outweigh the costs? Or are risks and costs greater?

As previously stated, the main risk FGD sees in a possible depositor preference, at least in a French or continental EU context, would be the consequences for bank financing, particularly in the interbank

debt market and in the general unsecured banking debt market. This is incidentally one of the main issues for financial stability in the current context.

Depositor preference would push bank financing more and more on the covered bond and securitization side and, paradoxically, would leave even less room for resolution if senior debt had to be involved (which, again, is not advisable). It would also leave fewer assets in the banks for claims' recovery.

As a whole, FGD considers costs and risks for financial stability greater.

25. What other measures could be contemplated to mitigate the impediments to effective cross-border resolution if such impediments arise from differences in ranking across jurisdictions? How could the transparency and predictability of the treatment of creditor claims in a cross-border context be improved?

See 21 and 22. It seems difficult to expect significant effects if some more important elements are not dealt with, and especially differences in debt issuance contractual terms and their consequences in the various jurisdictions legal systems.