

EFDI Non-Binding Guidance Paper

DEPOSIT GUARANTEE SCHEMES' ALTERNATIVE FUNDING POLICY

For submission to the EFDI EU Committee

Version as of 7 June 2018

DRAFT

TABLE OF CONTENTS

SUMMARY	3
1. INTRODUCTION	4
2. BACKGROUND AND STATE OF PLAY.....	5
2.1 LEGAL BACKGROUND	5
2.2 ADDITIONAL BACKGROUND ELEMENTS.....	6
2.3 STATE OF PLAY OF ALTERNATIVE FUNDING PRACTICES IN THE EEA	8
2.4 OPEN QUESTIONS RELATED TO ALTERNATIVE FUNDING POLICIES.....	10
3. NON-BINDING GUIDANCE	11

DRAFT

SUMMARY

- The 2014 Deposit Guarantee Scheme Directive¹ (DGSD – Art. 10) requires that Deposit Guarantee Schemes (DGSs) have adequate alternative funding arrangements in place to enable them to obtain short-term funding to meet their obligations. The purpose of this requirement is to ensure DGSs are prepared to fulfil their commitment towards depositors in all circumstances, even when facing a possible shortage or illiquidity of their existing resources.
- To implement this requirement, DGSs have only a few available options: credit lines, bond issuances, repos, ex-post contributions, other private sources. Their counterparties may be public or private. This EFDI note intends to offer an overview of the questions relative to the use, negotiation and implementation of those instruments and to bring EU and EEA DGSs some elements of support in that field.
- Each alternative funding instrument comes with its own characteristics and limitations. Besides the willingness or capacity of potential counterparties to contract with them and whether or not several instruments are available, DGSs have to consider a number of technical factors: first, if the instruments can bring additional resources, or rather liquidity; then, complexity, timing, associated requirements, interactions with investment policy, costs...
- The note proposes a set of recommendations for various features of alternative funding arrangements, both at the time of their definition and negotiation, and for their practical implementation: assessment of size, prerequisites, review of some specific terms, counterparty management, stress-testing.

VERSION MANAGEMENT

- **Draft Version: 2 May 2018**
- **Planned date for approval by EU Committee: 18 June 2018 (Prague meeting)**
- **Date next review: Year 20XX**

¹ Directive 2014/49/EU of the European Parliament and of the Council, dated April 16, 2014 on deposit guarantee schemes.

1. INTRODUCTION

1. In crisis situations, a DGS may face the risk of a possible mismatch between immediately needed resources and immediately available resources.

Such a mismatch may come from either insufficient, or illiquid resources, or both. In any case, gaining or preserving depositors' trust and fulfilling the pledge made towards a failing bank's customers by DGSs, besides the rigorous implementation of an efficient data and payment processing, will also require a responsive communication and a well-thought investment policy, so that they could also overcome the challenge of a possible shortage of resources.

2. While regulatory requirements and international standards became more and more stringent, DGSs develop new and complementary approaches to the resources issue.

The maximum payout delay for compensating depositors has been a key factor in this evolution. When DGSs were given three months, renewable once – the case in the EU until 2009 – to compensate the clients, they also had some comfort to raise additional contributions or find other sources of financing in the meantime. At that time, quite a number of DGSs were still explicitly relying on ex-post financing. With the emergence of the 7-day payout delay as an international reference, pure ex-post funded systems have recently started phasing out gradually. Existing ones are mainly backed through an immediate access to a third-party liquidity, be it the State or the Central bank. From now on, whether ex-post or ex-ante funded, all DGSs need to think and define an alternative funding policy ahead of any possible event.

3. Along this trend, two kinds of alternative funding arrangements, whether they encompass or not additional funding, have been under DGSs' scrutiny. Non-additional

funding arrangements address pure liquidity issues, for instance, when markets are adverse or not liquid enough. Such arrangements are typically collateralised by the DGS's existing assets. Additional funding arrangements aim at also addressing a resource shortage issue. They are uncollateralised, collateralised by future claims or assets, or backed by a state or other third-party guarantee. Practices, characteristics and issues raised may differ depending on those elements.

4. EFDI launched the DGSD2 Implementation Initiative ("D2I") to identify the main challenges and issues DGSs are facing in the implementation of 2014 Directive.

Supported by surveys circulated among EFDI members and workshops to discuss the topics among DGS experts, the D2I aims to develop non-binding guidance² and best practice regarding technical topics such as alternative funding arrangements. As part of this initiative, an *EFDI Alternative Funding Workshop* was held in Paris on 30 November 2017, jointly organized by the British *Financial Services Compensation Scheme*, the French *Fonds de Garantie des Dépôts et de Résolution* and the German *Compensation Scheme of Private Banks*. As a general outcome of this workshop, it appeared that while all DGSs work with different local governance and regulation and don't have the same

² The power to issue non-binding guidance is laid down in article 3.2 of EFDI statutes.

access to instruments, they all largely deal with the same challenges and impediments, when it comes to mobilize resources through alternative funding schemes within the required timeline.

2. BACKGROUND AND STATE OF PLAY

2.1 LEGAL BACKGROUND

5. The legal framework for EU DGSs is set by European Directive 2014/49/EU (“DGSD2”), enacted in 2014. As for alternative funding arrangements, Art. 10 (9) briefly provides that *“Member States shall ensure that DGSs have in place adequate alternative funding arrangements to enable them to obtain short-term funding to meet claims against those DGSs”*. It amplifies paragraph (1) of the same article, which indicates that raising the available financial means by contributions on member banks, *“shall not prevent additional financing from other sources”*.

6. IADI Core Principles address the resource issue in a similar way. Core Principle 9 (“Sources and Uses of Funds”) states that *“the deposit insurer should have readily available funds and all funding mechanisms necessary to ensure prompt reimbursement of depositors’ claims, including assured liquidity funding arrangements...”*. With more details, CP9 essential criterion 4 states that *“emergency funding arrangements for the deposit insurance system, including pre-arranged and assured sources of liquidity funding, are explicitly set out (or permitted) in law or regulation. Sources may include a funding agreement with the government, the central bank or market borrowing. If market borrowing is used it is not the sole source of funding. The arrangement for emergency liquidity funding is set up in advance, to ensure effective and timely access when required”*.

7. As part of the Guidelines on stress tests for DGSs³, the European Banking Authority (EBA) also formulates recommendations on alternative funding. Paragraph 93 requires that *“where ex ante funding is insufficient, DGSs should assess the adequacy of extraordinary ex post contributions and alternative funding means to meet the shortfall within the repayment deadline”*. These provisions are completed in Paragraph 94 with requirements related to the quality and effectiveness of such arrangements: *“Reliance on alternative funding means, such as loans or credit lines from public or private third parties, should be based on an objective assessment of elements known at the time of the test, such as mutual lending commitments entered into via written cooperation agreements, formal credit lines, etc...”*.

8. In line with those prescriptions, many of the European Union (EU) and European Economic Area (EEA) DGSs have already implemented alternative funding schemes or are in the process of assessing such mechanisms. Whilst *ex-ante* funding resources are being raised to reach the 2024 target level, additional funding schemes are also actively examined and put in place by DGSs to meet their needs for

³ EBA/GL/2016/04 – issued on 19/10/2016.

additional funding or liquidity sources in case of exceptional, but plausible circumstances.

2.2 ADDITIONAL BACKGROUND ELEMENTS

9. Depending on the local regulatory framework, the alternative funding instruments accessible to DGSs comprise of credit lines or loans, either from market participants or from a public entity, bond issuances, mutual lending and sale and repurchase agreements (“repos”), other private sources. Each instrument comes with its own characteristics and limitations. Among others, public support is subject to restrictions, while private support brings a counterparty risk. Repos can only offer a solution to a mere liquidity issue, whereas the other instruments may be used as an additional funding source. Bond issuance represents a specific challenge to comply with the short payout delay. Mutual lending remains theoretical at this stage.

- **Lines of credit with market participants** follow the rules of any lending contract with a bank. They imply an intensive negotiation process, leading to a detailed documentation reflecting the general guidelines of the local banking market. Among the elements to be kept in mind:
 - The borrower must fulfil over time various requirements that are essential to maintain the agreement into force, including regular information transmission and timely payments;
 - Those lines of course, if they are committed, come with a cost (at minimum, a “commitment fee”), as the pledge made by the lenders has an impact on their prudential ratios and lending capacities;
 - Signed with banks, such contracts put DGSs at risk, if the lender or one of the lenders defaults (“wrong-way risk”). This risk also exists with private repos.
- **When possible (see restrictions below), lines of credit with Central Banks, States or other public entities** are governed by ad-hoc agreements, with probably less documentation and possibly no specific fee before the line is drawn. On the opposite, the decision-making process may imply political decisions from authorities at a high level.
- **Bond issuances** are operated by DGSs, at this stage, with a State guarantee (in theory, a credit enhancement could also be obtained through a supra-sovereign guarantee). The bond program is structured under a prospectus (Information Memorandum), which contains full description of the issuer and the general conditions of the issue. The prospectus is accompanied by contracts signed with leading banks as primary dealers of the programme. Going forward, the shortening of the issuance delay might lead to adapt and speed up the issuance process.

- **Mutual lending among EU DGSs** is an option offered by DGSD2 (Art. 12). However, this provision of the Directive does not imply any obligation. 
- **Repo transactions** (cash obtained from mobilizing eligible market instruments in the hands of a third party) performed **with commercial banks** or other market participants require an appropriate documentation that should be set in advance to ensure a swift execution. Following the applicable market standards, this documentation defines:
 - eligible instruments - typically high-quality assets with minimal market requirements (government bonds, supranational issuers, covered bonds...)
 - repo parameters (maturity, haircut). Those parameters depend on the mobilized assets (shorter maturities and higher haircut rates go with higher credit risks) and become stricter when the value of the assets drops.
- **When possible, repo transactions** may also be entered to **with Central banks** (or other public entities), using applicable operating rules. Central banks typically tend to set i) specific eligibility criteria on issues and ii) haircut rates higher than those of commercial banks. 
- **Other private sources:** a private funded third-party, close to a DGS, may be willing to support a troubled DGS as this party has itself an interest in stabilising the DGS (e.g. because of a long-lasting cooperation with most of the customers or with the banks protected by the DGS). 

10. Within the Eurosystem, the prohibition of monetary financing brings very tight limits to DGSs funding by National Central Banks (NCBs). The financing of DGS's obligations by an NCB falls under the prohibition of monetary financing applicable to public authorities and other bodies governed by public law (Article 123 of the Treaty on the functioning of the EU). The European Central Bank has specifically addressed this issue in its Convergence Reports in 2010 and 2014, as well as in various opinions (e.g. opinions CON/2011/83 & 84). For instance, Opinion CON/2011/83 indicates that:

- *"The only compatible forms of central bank financing of DGSs are: (a) intraday credit in line with the general rules on provision of such credit by the central bank, and (b) short-term emergency liquidity financing under strict conditions established in the ECB's Convergence Reports [...]"*;

whereas the 2014 Convergence Report specifies that:

- *"National legislation which provides for the financing by a NCB of a national deposit insurance scheme [...] would be compatible with the monetary financing prohibition only if it were short term, addressed urgent situations, systemic stability aspects were at stake, and decisions were at the NCB's discretion"*; and
- *"In particular, central bank support for deposit guarantee schemes should not amount to a systematic pre-funding operation"*.

As a whole, it seems eurozone DGSs could hope getting access to some short-term financing from their NCB under crisis circumstances (possibly under 3 months, offering them some time to raise ex-post contributions, or through intraday repos for instance). However, it makes no doubt that eurozone DGSs could not rely on such a financing, for which the final decision will stay in the hands of NCBs until the last moment. Therefore, NCB financing cannot be considered as a secured and viable source of alternative funding in DGSs alternative funding policy. In addition, it is quite likely, possibly depending on jurisdictions, that NCBs would require collateral for such a financing.

11. Ex-post contributions are an additional resource and liquidity management tool in DGSs' toolkit. Ex-post contributions are distinct from "alternative funding" in regulatory texts above. Still, if raised within the payout delay, they bring the same relief in case of immediately available resources shortage. Whilst raising additional contributions in the payout delay has become obviously more challenging with the shortening of that delay, this tool remains an option to DGSs. As they work on streamlining their operational processes, they can also consider, within the existing legal framework⁴, speeding up operationally, as well as in terms of their decision-making on raising contributions and completing their resource management tools they can get access to.

12. Last, investment policy and alternative funding are closely intertwined. Both concur to the liquidity management of DGSs' resources. The mandate and regulatory framework of EU and EEA DGSs set for them two main investment objectives: liquidity and security. DGSs should be able to react swiftly in times of crisis with all possible market configurations; they define and implement their investment policy accordingly.

Still, on one hand, the alternative funding policy factors the remaining liquidity risk associated with the implementation of the investment policy: illiquid or adverse markets, market risk in general, counterparty risk, mismatch risk, wrong-way risk... (see EFDI non-binding guidance on DGSs' investment policy). On the other hand, alternative funding constitutes another lever for liquidity management, allowing for instance to slow down asset liquidation in adverse markets or to better cope with frozen markets, with a possible impact on the way the investment policy is defined and conducted. In a nutshell, alternative funding policy and investment policy gain at being designed in relation with each other.

2.3 STATE OF PLAY OF ALTERNATIVE FUNDING PRACTICES IN THE EEA

13. According to the survey conducted in November 2017, European DGSs experience a wide variety of approaches when it comes to alternative funding

⁴ DGSD Art. 10 (8): "If the available financial means of a DGS are insufficient to repay depositors when deposits become unavailable, its members shall pay extraordinary contributions not exceeding 0,5 % of their covered deposits per calendar year. DGSs may in exceptional circumstances and with the consent of the competent authority require higher contributions.

The competent authority may defer, in whole or in part, a credit institution's payment of extraordinary ex-post contributions to the DGS if the contributions would jeopardise the liquidity or solvency of the credit institution".

schemes. This variety should be put in context of the regulatory framework in which each one works, especially between eurozone and non-eurozone members, as well as in regard to their position within the institutional safety-net framework.

The situation seems also to change quickly, EU DGSs being more and more active in this issue. Globally, it looks that a trend towards more commercial banks financing, collateralized or not, is spreading out. A significant number of respondents have concluded, started or planned negotiations in relation with such credit lines from private sources. As a matter of fact, it is also striking to observe that some of the DGSs seeking for private alternative funding, already benefit from some sort of public support.

Incidentally, some DGSs are recognized as participants to the Central Bank wire system with the capacity to receive and send funds, as well as to process repos. It appears that such a system is implemented in various jurisdictions under proper agreements or market rules.

The survey highlighted the following findings.

- **Non-additional funding:** 25% of respondents have already implemented some arrangements (collateralized loans or repos) and 25% plan to implement such schemes. Roughly 90% of those, who have implemented, or plan to implement such arrangements, look for commercial banking counterparties (usually under a repo format for those already put in place), while a limited number favors Central Banks or other public funding.
- **Additional funding:** 40% of respondents have already structured solutions to secure additional funding, while 40% are planning to do so. Among those two populations, 70% consider credit lines as a preferred scheme, whereas 20% favor the collection of additional contributions and less than 10% think of issuing bonds. As for credit lines, more than half of DGSs would look for commercial banking counterparties, 1/3 for the State and some for Central Bank facilities.

Except for the support by National Central Banks, the results of the survey seem quite similar for Eurozone and non-Eurozone DGSs. As in the non-Eurozone, some Eurozone DGSs rely or intend to rely on the State to provide them for non-additional funding, additional funding, or both. However, in line with the prohibition of the monetary financing mentioned above, no additional or non-additional funding arrangement with a National Central Bank has been registered.

14. EU and EEA DGSs identify various impediments and constraints they have to face when implementing their alternative funding agreements.

- **Repos:** even if repo schemes usually match with plain vanilla repo transactions with banks (limits, eligibility, haircuts...), respondents stress the collateral

management constraints associated with repos, as well as the level of fees, based on the size of credit facility.

- **Commercial credit lines:** those lines require intense negotiations and are all the more expensive that the DGS has no or limited other business to offer.
- **State support:** governments are usually reluctant to make that ex-ante support explicit. In most often cases, the State support remains implicit and comes as a last resort option, when all other sources have been exhausted.

2.4 OPEN QUESTIONS RELATED TO ALTERNATIVE FUNDING POLICIES

15. DGSs are faced with a series of practical questions when defining and implementing an alternative funding policy. Most of those questions are not linked to European regulation, which provides a simple, but clear and relevant objective. In exchanging their experiences in the field of alternative funding, EEA DGSs have not identified any specific need for further or more detailed regulation in that field; their possible concerns belong to the field of actual practices. Apart a general check about the leeway offered by each national legal framework, the main issue for DGSs is actually to define in a rather uncharted territory the markers and guides that will best fit with their own needs and constraints.

- **Legal restrictions:** the first question to examine is the one of DGSs' legally recognized powers, according to the local legal framework and their own statutes. For instance, the capacity to contract a loan may need a formal inscription in the law. Not all DGSs can issue on the bond market, not all have access to a Central Bank financing or government guarantees. As public debt, the borrowing might require the authorization of public authorities on a case by case basis. The duration of the borrowing can be constrained, too. These questions are proper to each jurisdiction and will not be addressed further in this note, only to mention that the more flexible options DGSs have access to, the better they can fulfil their mission.
- **Purpose and size:** should the DGS alternative funding solution be raised as an additional funding source or as a non-additional funding source? Given that purpose, the characteristics of the DGS and the risks it faces, what should be the amount of alternative funding to be sought for?
- **Instruments and counterparties:** what kind of alternative funding instruments (credit line, repos...) and which counterparties could be and should be privileged? What legal and technical capacities does this format require from the DGS, should the DGS seek for external expertise to build the alternative funding solution it seeks for?
- **Waterfall:** in case several alternative funding options are available, in which order should they be mobilized? Should public funding be considered as the last resort

option?

- **Monitoring, stress-testing and regular reassessment:** how should the alternative funding policy be managed over time? How should it be integrated in the stress-testing program of the DGS? In which extent a regular assessment is needed?

3. NON-BINDING GUIDANCE

Upon the basis of these background analyses, practices and questions, EU and EEA DGSs are proposed the following elements of guidance to help them in the definition and implementation of their alternative funding policies.

16. Interaction with the DGS's investment policy: DGSs should define and assess their alternative funding policy in close conjunction with their investment policy⁵, and possibly do that simultaneously. As they should match the gap between immediately needed resources and immediately available resources, alternative funding instruments' nature and size depend on the actual liquidity and risk of invested assets. Reversely, the constraints linked to accessible alternative funding instruments may lead to select invested assets in regard of their possible use as collateral in a non-additional funding scheme; or, the availability of significant sources of alternative funding may lead to configure a less liquid, riskier, and potentially more lucrative investment policy.

17. Size of the alternative funding reserve: in accordance with paragraphs 93 to 96 of the EBA Guidelines on DGSs stress-tests⁶, additional alternative funding and ex-post contributions available to the DGS within the payout delay should at least match the gap between immediately available existing resources (which may include non-additional alternative funding instruments) and the DGS's target level (i.e. between 0.5 and 0.8% depending on the DGS). The sizes of additional and non-additional funding instruments are therefore correlated, and also dependent on the investment policy itself.

To determine the size of the alternative funding reserve they need, DGSs may also find advantageous to compare their immediately available resources with assessments of their potential liabilities in a crisis situation, for instance and when appropriate:

- through a quantitative model approach,
- or considering a single failure of the largest covered deposit base they might have to compensate,
- or a multiple failure with the second and third largest covered deposit bases etc.,
- also taking into account, as the case may be, the size of the Resolution Fund.

⁵ See EFDI non-binding guidance paper on "DGS Investment Policy" as per June 2018.

⁶ See in particular EBA/GL/2016/04 – paragraph 96 – 4/: "A funding capability test: a test measuring the financial capability [...] assuming a DGS intervention of a level of at least 0,8% of covered deposits or, where a lower target level has been set in conformity with Article 10(6) Directive 2014/49/EU, that lower target level."

18. Selection of the alternative funding instruments: the selection of the instruments closely depends on the DGSs' own environment (e.g. eurozone or not, willingness of public authorities), their statutes and positioning (e.g. public, hybrid or private), as well as on the way they implement their investment policy (e.g. invested assets directly on the DGS balance sheet or through UCITS managed by external asset managers). If DGSs' self-interest would lead them to rely on multiple instruments, they may be left with only one option in the end, especially when it comes to additional funding.

Where several instruments are available, it looks equally difficult to set rules for the order to trigger each of them, as the waterfall could be constrained by the instruments themselves, contracts or counterparties (e.g. public authorities accept to extend a support only as a last resort option), by the circumstances (e.g. additional funding required, not just liquidity management; or market conditions, or size). Costs and time considerations may also play in the waterfall preference.

19. Alternative funding instruments and ex-post contributions' terms and parameters: all instruments come with a specific documentation that needs to be properly reviewed by DGSs and, as far as practicable, carefully drafted. The support of external expertise to cope with the legal and technical aspects of chosen instruments, may be considered by DGSs, especially in the negotiation phase.

- **Credit lines:** DGSs may pay special attention to various provisions of the agreement.
 - DGSs should obtain a binding commitment from lenders, i.e. without any prior checks, nor any possibility for the lenders to withdraw from the agreement when the DGS notifies its decision to draw on the credit line.
 - DGSs should make sure that standard provisions included in the usual legal apparatus of those lines such as, inter alia, *material adverse effect*⁷, *cross-default termination*⁸, *cash flows set-off*⁹, priority re-payments, major litigations, anti-money laundering and anti-terrorism provisions, as well as various restrictions clauses¹⁰ will not restrain in any way the capacity of lenders to execute the financing within a payout or resolution context.
 - DGSs should also factor the possibility that the default bank could be one of the lenders of the credit line (wrong-way risk); as other lenders are only committed for their own exposures, the share of that lender will not be distributed among other counterparties and the size of the line will be diminished accordingly; lenders ratings and financial robustness are worth a regular assessment.

⁷ This provision enables the lender to refuse funding the loan if the borrower suffers such a change.

⁸ This one puts a borrower in default if the said borrower defaults on another obligation.

⁹ This clause directs any incoming cash-flow to the reimbursement of the credit line when drawn.

¹⁰ Limitations clauses are usually included in credit agreements on investments: capacity to subscribe or increase debts, to subscribe or increase any credit to third parties, capacity to enter in any kind of lien or privilege etc.

- Under loan market standards, it may take two days for the lenders to make resources available from the time the credit drawing notice is received by the paying agent of the credit¹¹. In such a case, the credit agreement may include a so-called “*swingline*”, by which a fraction of the committed amount of the total line, with possibly a different interest rate¹², can be wired on an intra-day basis.
- Additional funding credit line would typically come uncollateralized. However, lenders may require the posting of future claims (ex-post contributions, proceeds of the liquidation etc.) which may limit the capacity of DGSs to collect resources for themselves and may make the arrangement both more complex and less costly.
- **Bonds:** to shorten the issuance delay, DGSs might consider, ahead of any event, obtaining the needed authorizations from market authorities and signing contractual documentation with dealers. They might also consider issuing the bonds simultaneously with the organisation of an electronic auction. Bonds would be issued in the required amount on the issuing vehicle books and immediately sold according to the auction results on the secondary market, unless the bonds are subscribed in a closed circle of banks.
- **Repo transactions:** while conducted under the applicable market standards, those transactions require special care from DGSs:
 - the execution of the appropriate documentation might take time;
 - as collateral posted with commercial banks shall be of high quality, a review of both the DGSs’ assets (instruments, ratings) and the eligibility rules to repos should be regularly performed;
 - the liquidity support brought by this instrument should be tested under stressed market conditions.
- **Ex-post contributions:** DGSs should work on shortening the delays to raise ex-post contributions. This may imply several prerequisites.
 - a predefined accelerated decision-making process with the possibly involved authorities (designated authorities, National Central Bank, Treasury...), for both authorizing the DGS to raise those ex-post contributions and bringing them with no delay the waivers mentioned in Article 10 (8) of DGSD2¹³ if so needed;
 - a specific contribution calculation: in such a context, as little time would be available to update contributions parameters (individual covered deposits and risk factors), DGSs might also consider, in the permitted extent, to raise

¹¹ Some DGSs, such as FSCS in the UK enjoy a 1-day pre-advance notice.

¹² For instance, in eurozone countries, a committed line of credit is usually indexed on Euribor, whereas a swingline is indexed on EONIA.

¹³ See footnote 4 above.

contributions on the same basis than (as a proportion of) the last contributions raised;

- an expedited contribution raising process: within an adequate regulatory or contractual framework, DGSs might assess the possibility to raise contributions, not by issuing and sending invoices to member banks, but through a notification to members, followed by a direct debit on their accounts with the Central Bank.

20. Counterparties: in dealing with counterparties, DGSs should monitor their concentration risk over those counterparties, especially on private and banking counterparties, and try to mitigate their operational risks and, in the case of domestic banks, their wrong-way risk (failure of a bank which is also a counterparty of the DGS)¹⁴.

In all cases, DGSs should consider and monitor the risk associated with their counterparties in those operations. They may develop eligibility criteria (e.g. lenders bank appropriate ratings) and define limitative rules (e.g. duration, size), to select the counterparties they work with and the general conditions they will accept from them.

21. Stress testing: As for the definition of the policy, alternative funding instruments should be tested in relation with the investment policy along operational stress tests and scenarios ascertaining the potential liquidity and resources requirements faced by each DGS in a crisis event and difficult or extreme market situations; the EBA-guidelines gave some hints for suitable elements of such a stress test.

•

22. Accounts with the Central Bank and the Central Securities Depository: For the sake of swift resources mobilization, if not already the case, DGSs could ask for holding an account with their National Central Bank. The use of an account with the Central Bank allows the DGS to shorten money transfer delays and get intraday liquidity either from the Central Bank itself, when permitted, or from its banking counterparties.

Similarly, DGSs may enter in agreement with their Central Securities Depositories which will operate the repo settlements on an intra-day basis.

*

¹⁴ This principle also applies to the DGSs' cash correspondents in the payout currency, to avoid the case where a unique cash correspondent bank would default.