EBA EUROPEAN BANKING AUTHORITY

Guidelines on methods for calculating contributions to DGSs

Public hearing, London, 8th January 2015

Outline

1. EBA and the DGSD
2. Risk based contributions: Mandate and timeline
3. Objectives
4. Necessary elements of calculation methods
5. Calculating the Aggregate Risk Weight
6. Optional elements of calculation methods

1. EBA and the new DGS Directive

- Publication date: 12.06.2014
- Transposition: 3.07.2015
  - But risk-based contributions can be postponed until 31.05.2016
  - Emergency payout: 31.05.2016
  - Full phase-in of 7 working days repayment deadline: 31.12.2023
- EBA role:
  - Financing:
    - Informed of level of ex-ante financing
    - Guidelines (GL) on payment commitments – Art. 10(3) DGSD
    - **GL on risk based contributions – Art. 13(3) DGSD**
      - Informed of DGS own risk based methods
      - Report on calculation models 2019
  - Home-host DGS cooperation:
    - Informed of inter-DGS borrowing Art. 12(1) DGSD
    - Informed of and mediates on intra EU cooperation agreements
  - Other monitoring tasks:
    - Collects information on covered deposits from MS by 31 March each year
    - Peer reviews on stress tests every 5 years

2. EBA mandate on DGS risk based contributions

Article 13(3) of the DGSD

- In **order to ensure consistent application of the DGSD** the EBA shall issue guidelines to **specify methods for calculating contributions to DGSs**
- in particular, such guidelines, shall include a **calculation formula, specific indicators, risk classes** for members, **thresholds for risk weights assigned to specific risk classes**, and other necessary elements

In line with EBA Regulation:

- « provide a high level of protection to all depositors in a harmonised framework throughout the Union".

Addressees of Guidelines

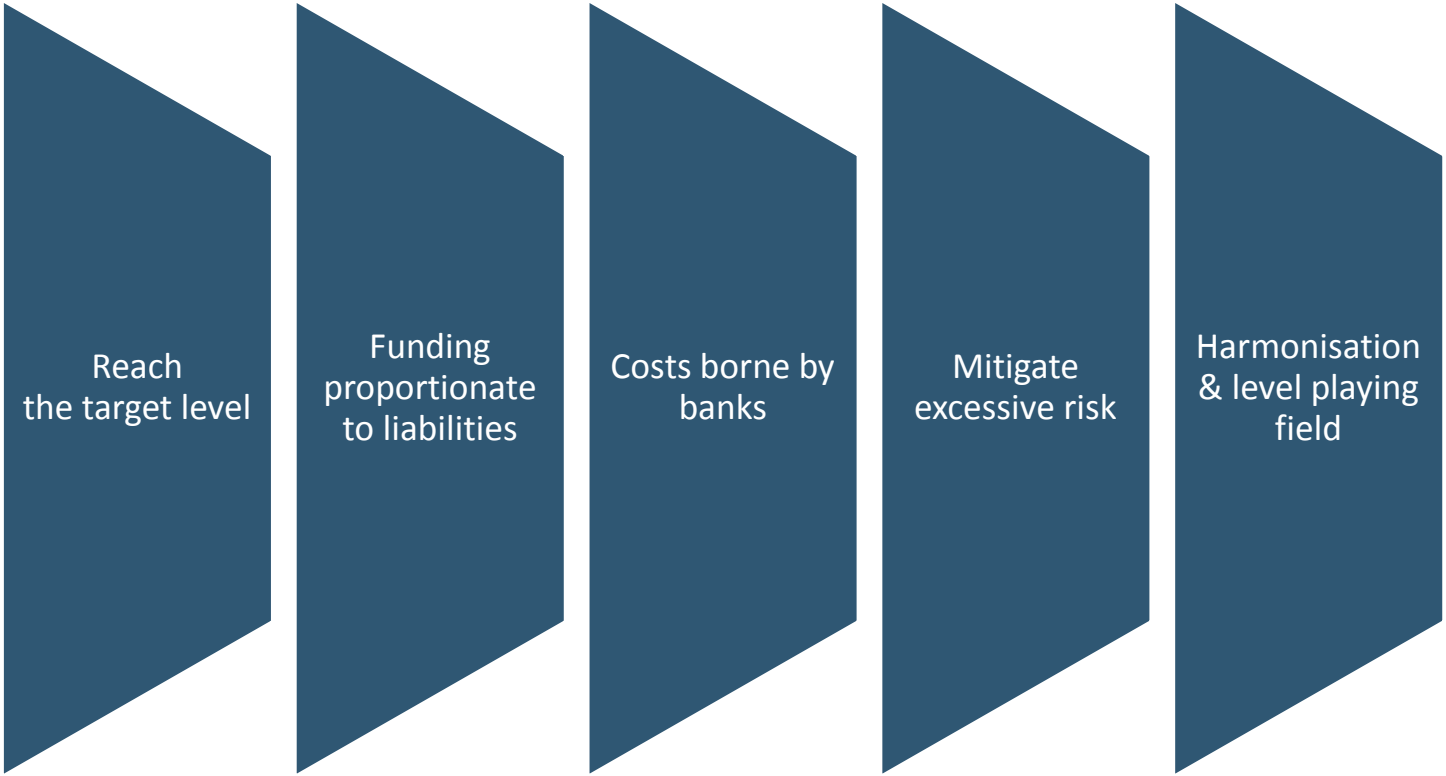
Designated authorities (Public DGS or supervisor of private DGS)

Competent authorities (approve own-risk based models)

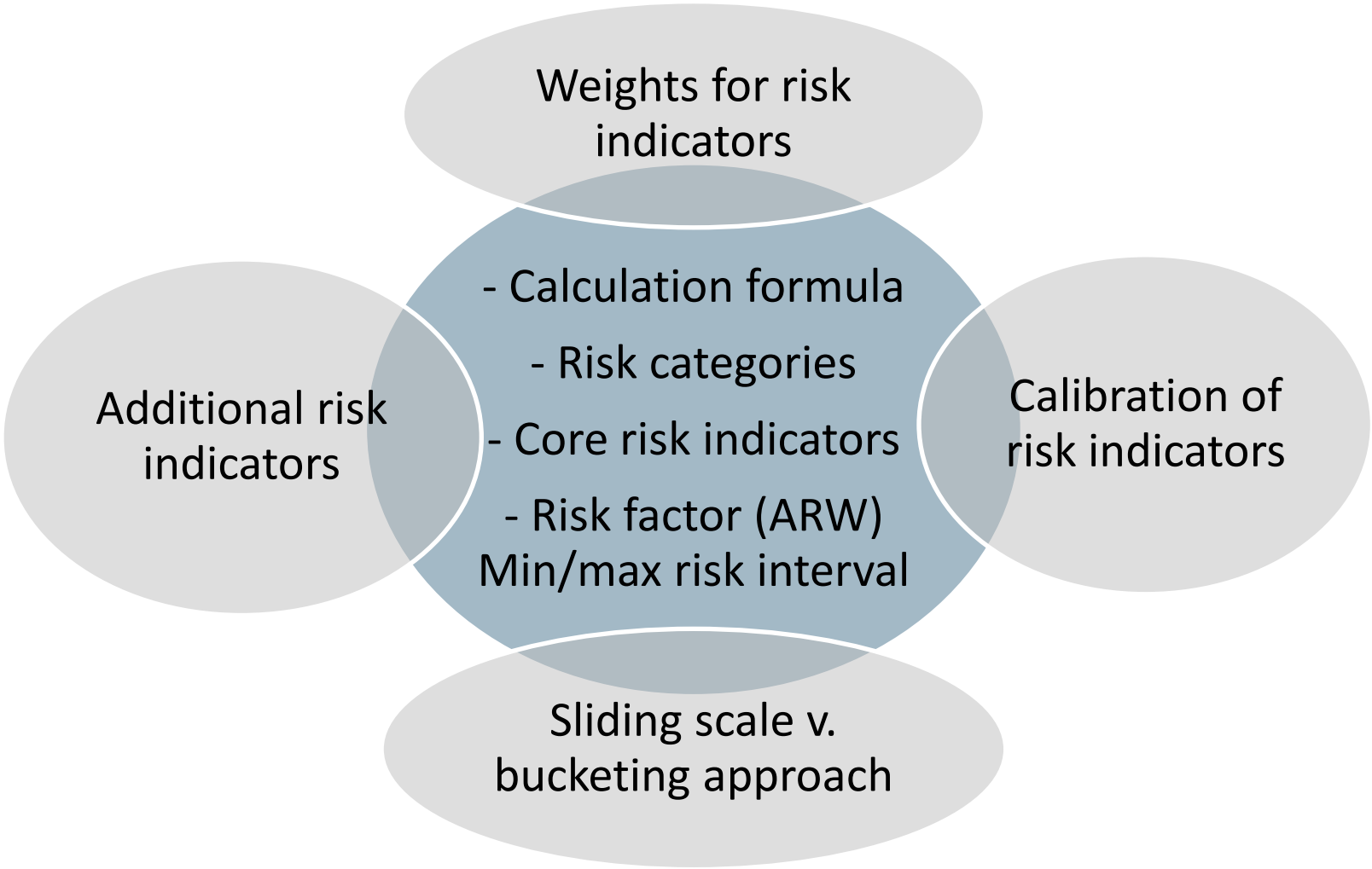
2. Timeline


TEST
Feb-April 2014
CONSULT
… 11 Feb 2015
ADOPT
May 2015
COMPLY/ EXPLAIN
End 2015
REVIEW
July 2017

3. Objectives of calculation methods



4. Necessary elements and flexibility



4.1. Calculation formula

$$C_i = CD_i \times CR \times ARW_i \times \mu$$

Where:

C_i	=	Annual contribution for institution i
CD_i	=	Covered deposits for institution i
ARW_i	=	Aggregate Risk Weight for institution i
CR	=	Contribution rate
μ	=	Adjustment coefficient

4.2. Covered Deposits

$$C_i = CD_i \times CR \times ARW_i \times \mu$$

- Article 13(1) of DGSD: ”contributions to DGSs …. shall be based on the amount of covered deposits and the degree of risk incurred by the respective member”

4.3. Contribution Rate

$$C_i = CD_i \times CR \times ARW_i \times \mu$$

- **Contribution Rate (CR)** – percentage of its covered deposits which a bank with an average risk weight should contribute each year in order to ensure reaching the annual target level:
- Identical for all banks.
- CR = annual target level / amount of total covered deposits of the DGS members in a given year.
- Annual target level = amount to absolute target level / number of years to target (e.g. 0.08%) → spread the burden as evenly as possible.

4.4. Aggregate Risk Weight

$$C_i = CD_i \times CR \times ARW_i \times \mu$$

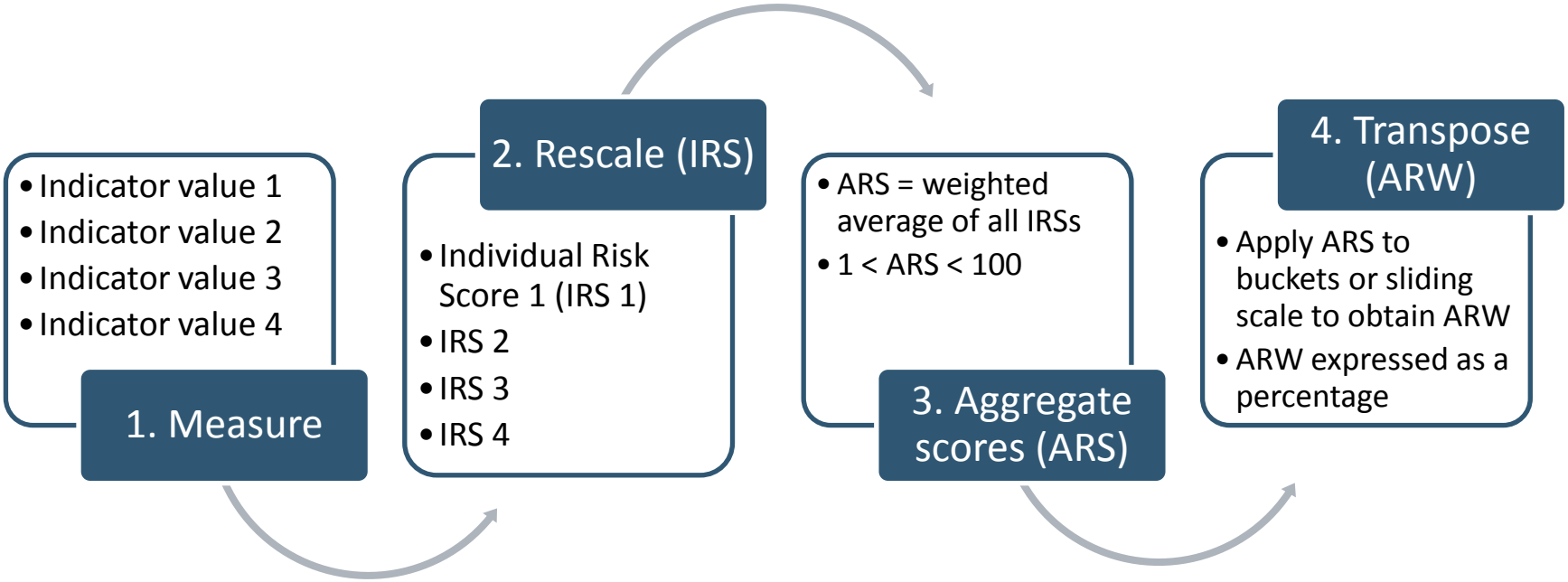
- Risk factor specific for each institution's profile
- Calculated on the basis of individual risk indicators
- ARW assigns banks to risk classes (in the bucketing approach) or determines their relative riskiness (in a siding scale approach)
- Lowest and highest ARW should vary within a range:
  - At least between 75% and 150% of average;
  - In principle within 50% and 200% of average – with exceptions.

4.5. Adjustment coefficient

$$C_i = CD_i \times CR \times ARW_i \times \mu$$

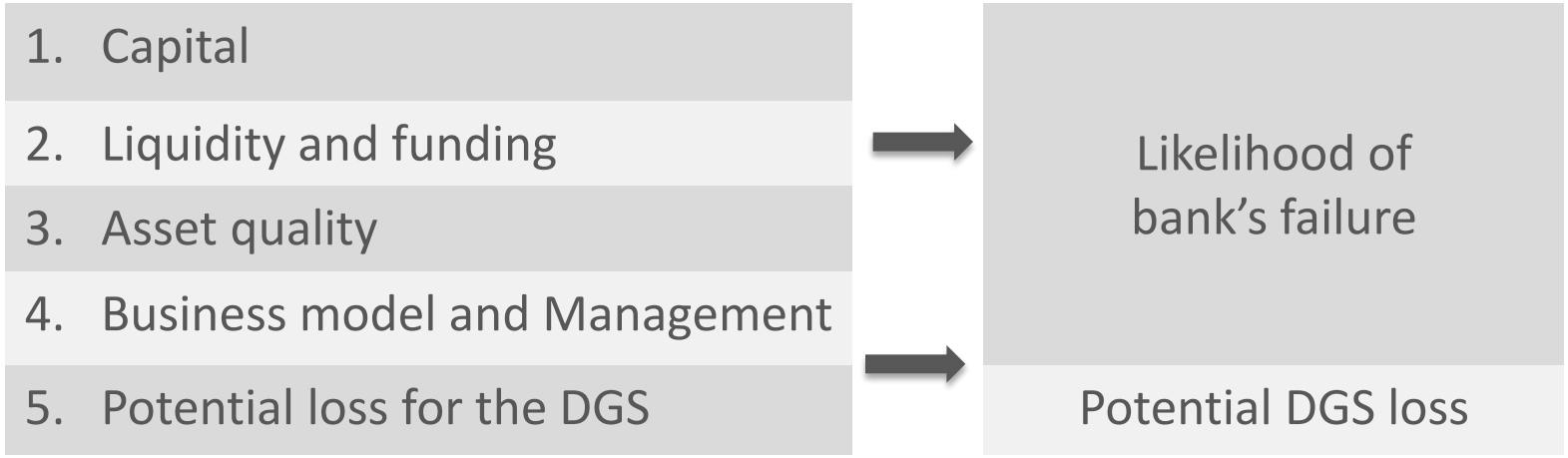
- **Adjustment coefficient (μ)** – an additional technical parameter (applicable to all DGS members in a given year):
  - ensuring that the DGS reaches annual target level (avoiding undershooting/overshooting)
  - allowing to reflect the current business cycle in the amount of contributions paid by each DGS member

5. Calculation of the ARW in 4 steps



5.1. Step 1 – measuring risk indicators (1/3)

- **Five risk categories:**



5.1. Step 1 – measuring risk indicators (2/3)

- 8 core risk indicators that must be used and account for at least 75%.
- A non-exhaustive list of additional risk indicators that may be used on top to the core indicators, up to 25%.
- In exceptional circumstances, possibility to remove core indicators if not available for legal reasons
- Any additional indicator cannot, on its own, account for more than 15%, except qualitative indicators in the category Business Model and Management (e.g. IPS membership)

5.1. Step 1 – measuring risk indicators (3/3)

List of core indicators

Risk categories and core risk indicators	Minimum weight
1. Capital	18%
1.1. Leverage ratio*	9%
1.2. Capital coverage ratio or CET1 ratio *	9%
2. Liquidity and funding	18%
2.1. LCR*	9%
2.2. NSFR*	9%
3. Asset quality	13%
3.1 NPL ratio	13%
4. Business model and Management	13%
4.1. RWA / Total Assets*	6.5%
4.2. RoA	6.5%
5. Potential losses of the DGS	13%
5.1. Unencumbered assets / Covered deposits	13%
Sum	75%

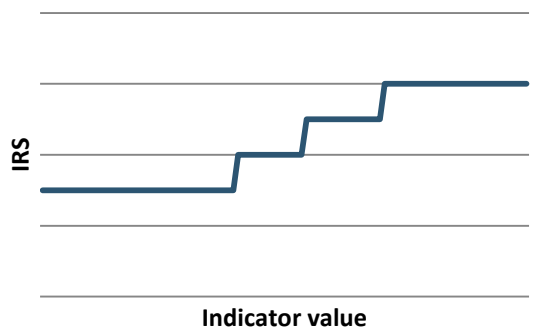
5.2. Step 2 – scoring risk indicators (2/2)

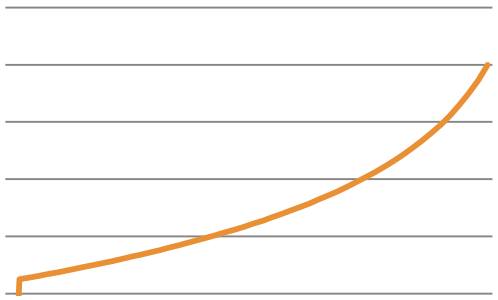
- Individual Risk Scores (IRS) are used to rescale indicators' values, into a common and comparable scale (1-100)
- An option is given to use:

Bucketing approach
Assigning various/discrete IRSs to a range of values of an indicator

OR

Sliding scale approach
Each value of an indicator can be transposed into a unique IRS





5.2. Step 2 – scoring risk indicators (2/2)

- No specific thresholds for each core risk indicator
- General guidance on calibrating indicators (determining lower/upper boundaries of individual buckets, or for a sliding scale):
  - ensuring sufficient and meaningful differentiation of member institutions
  - If the bucketing approach is used:
    - at least 2 buckets for each risk indicator should be established
    - there is a choice of having buckets determined on an absolute or relative basis
  - avoid calibrating the boundaries in a way that all member institutions, despite representing significant differences in the area measured by a particular risk indicator, would be classified into the same bucket.
  - taking into account, where available, regulatory requirements applicable to the member institutions and historical data on the indicator's values.

5.3. Step 3 – Aggregating the Individual Risk Scores

- Individual Risk Scores (IRS) for all risk indicators are multiplied by weights assigned to these indicators and summed up, via an arithmetic average, to calculate **Aggregate Risk Score (ARS)** ranging from 1-100

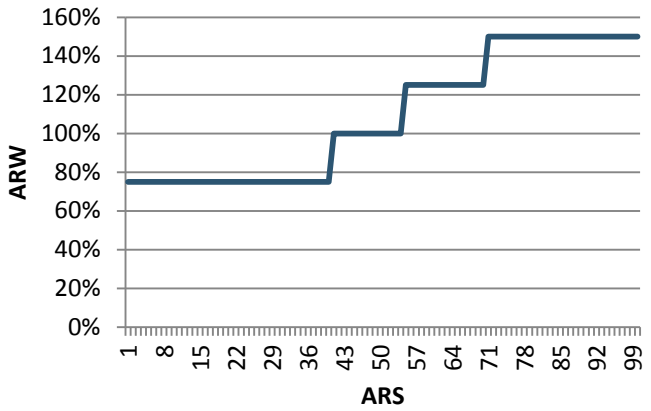
$$ARS_i = \sum_{j=1}^{n} IW_j * IRS_j$$

5.4. Step 4 - the Aggregate Risk Weight (ARW)

- The ARS is transposed, by using a sliding scale approach or a bucketing approach, into an **Aggregate Risk Weight (ARW)** ranging from 50% to 200%

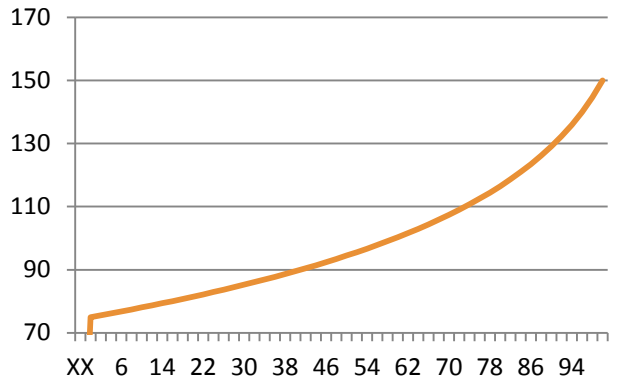
ARS ➡ ARW

Bucketing approach



OR

Sliding scale approach



6. Optional elements of calculation methods

- Incorporating into the calculation method options and national discretions given to Member States in the DGS Directive

Minimum contributions	• Fixed fee in addition to risk-based contributions, OR • Minimum fee instead of the risk-based contribution (if the risk-based contribution is lower than the minimum fee)
IPS membership	• To be reflected in "Business model and Management" (≤25%) • If IPS not recognised as a DGS: decreasing the member's ARW to reflect the additional solvency and liquidity protection provided by the scheme to the member (funding of IPS / TA of member) • If IPS recognised as a DGS: increasing the ARW for central entities
Low-risk sectors	• Reflected in the category "Business model and Management" • Regulated under national law • Regulation reduces likelihood of failure • Empirical evidence that occurrence of failure is consistently lower

Conclusion

Sound harmonised minimum formula for risk-based contributions

- Will reach the target level in time while respecting the business cycle
- Will contribute to risk discipline
- Will ensure a level playing field in the internal market

Respects variety of business models and national banking sectors

- Flexibility on criteria, scoring, intervals

Respects national options foreseen by the Directive

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