Fondo Interbancario di Tutela dei Depositi

FITD answer to EBA consultation

on methods for calculating contributions to Deposit Guarantee Schemes

10 febbraio 2015

Fondo Interbancario di tutela dei Depositi - Italy (FITD) welcomes EBA guidelines on methods for calculating contributions to DGS. We find the framework used close to the one in use in Italy. FITD has been using a risk based contribution system since 1987, based on ratios, thresholds and weights to assess member banks' riskiness.

EBA questions related to the draft guidelines

Q1. Do you have any general comments on the draft Guidelines on methods for calculating contributions to DGSs?

Yes, FITD has some general comments.

FITD agrees on the general approach of the guidelines based on ratios, thresholds and weights. The EBA method for calculating contributions is clear and well applicable.

FITD acknowledges Art. 13, paragraph 2 of Directive 2014/49/EU, "DGSs may use their own risk-based methods for determining and calculating the risk-based contribution by their members" and that the EBA Guidelines also apply to already existing systems (Art. 13, paragraph 3). Where the DGS uses its own risk-based method, the Competent Authority has to ensure that the Guidelines are respected when approving own risk-based methodology[1].

Principle 8 of the Guidelines states that "*Calculation methods should be consistent with relevant historical data*". FITD agrees. As all DGSs currently using a risk-based system, FITD already fully relies on this principle to build its own ratios. FITD periodically recalibrates its calculation method in order to take into account time-series data.

Compliance with Principle 8 would imply that FITD continue to apply its own ratios even if different from those suggested by EBA.

Q2. Do you consider the level of detail of these draft Guidelines to be appropriate?

Yes. More flexibility should be allowed in the composition of the list of core indicators.

[1] EBA Guidelines, Background and Rationale, n. 12.

Q3. Is the proposed formula for calculating contributions to DGS sufficiently clear and transparent?

Yes.

Q4. Considering the need for sufficient risk differentiation and consistency across the EU, do you agree on the minimum risk interval (75%-150%) proposed in these Guidelines?

No, FITD disagrees. These is not any rationale to have a wider range for increasing contribution depending on the risk level than for decreasing it.

FITD suggests a minimum symmetric interval of 75% - 125%.

Q5. Do you agree with the core risk indicators proposed in these Guidelines? If not, please specify your reasons and suggest alternative indicators that can be applied to institutions in all Member States. Do you foresee any unintended consequences that could stem from the suggested indicators?

FITD does not feel in agreement with the core risk indicators proposed in these Guidelines.

EBA set of ratios (core and additional) should be broader, giving a DGS room to maintain or introduce ratios from its own experience. This approach we find is supported in Principle 8.

Given our experience, core indicators should include some ratios with a high capability to distinguish between sound and problematic banks. For example, in the FITD model, the ratio A1 (bad loans/own funds) well expresses the riskiness of member banks. Furthermore, the cost income ratio has a higher discriminant power than the RoA.

With regards to the “potential losses for DGS” risk category, FITD basically agrees on taking into account this profile when determining the overall banks risk.

However, FITD disagrees on the calculation method that the Guidelines apply to combine this risk profile (DGS potential losses) with the other four risk categories.

These four risk categories yield the probability of default (PD) of the bank (or aggregate risk score - ARS) that should be distinguished from the potential losses for the DGS (loss given default - LGD). This derives from both literature and risk management practice. Summing the two factors could biased the results and it is methodologically wrong. PD has to be combined with LGD as a multiplicative factor (with a specific weight) for computing the Expected Loss (EL). The "specific weight" has to be estimated upon historical data.

Also, FITD disagrees on the specific indicator proposed by EBA for measuring DGS potential losses (unencumbered assets over deposit ratio). The DGS LGD should be estimated also considering expected unencumbered assets recovery rates.

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On unintended consequences: FITD would wish to focus on one provision included in the requirements for risk indicators (page 27, number 58): "*For each institution the values for risk indicators should be calculated on a solo basis. The indicators calculated on a consolidated basis can be used (according to art. 7, 8 or 21 od Regulation EU 575/2013) if member banks received a waiver from meeting capital or liquidity requirements on a solo basis.*"

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It is unclear whether, upon the occurrence of the circumstances provided by the guidelines, the calculation of the indicators on a consolidated basis should only cover the ratios affecting economic quantities that are involved in the application of the exemption (e.g. capital and / or liquidity indicators) or the entire set of indicators (core and additional) listed in the GL.

It can be assumed that:

1) calculation on a consolidated basis covers all the indicators listed in the guidelines. As a result, all bank joining a banking group will only have ratios deriving from the consolidated balance sheet;

2) calculation on a consolidated basis only applies to capital and liquidity indicators. In this case, risk assessment would follow a "mixed" approach: indicators calculated on a solo basis would be used together with consolidated ratios;

3) a third option would be the case of a DGS that, although upon the occurrence of the circumstances provided by the guidelines, decides to not avail itself of the possibility to calculate indicators on a consolidated basis and to apply the general guidance to calculate ratios on a solo basis. But, indicators under the application of the waiver could not be available. Results would be the same as in option 2).

   This is the case for Italy. FITD has a system of ratios calculated on a both consolidated and solo basis but liquidity indicators LCR and NSFR are only reported to the supervisor on a consolidated basis for banks joining a banking group. The result is that FITD could not be compliant with the guidelines.

Each of the three options presents critical profiles.

Option 1 makes a full equalization of the indicators for all banks joining a banking group. The “group effect” is acknowledged and fully justified from an economic perspective; this approach is also applied by rating agencies. However, substituting consolidated indicators to indicators on a solo basis would imply that possible specific high risk conditions are not detected and therefore not discouraged. This problem could be solved by trying to combine the individual risk with that on a group level, as suggested below.

Options sub 2) and 3) both have the cons of a “mixed” approach, as specified above.

Issues resulting from option 1 could be solved as follows.

a) Introducing safeguards in calculating consolidated indicators.

The indicators of a bank joining a banking group are calculated on a consolidated basis. If such a bank is highly risky, the bank risk profile is assessed on a solo basis. This is the approach currently applied by FITD.

b) Introducing a notching down/up ratio in the additional indicators set.

The indicators of a bank joining a banking group are calculated on a consolidated basis. Additional indicators include a factor ratio that measures the bank level of risk. If such a bank is highly risky, the factor ratio assumes positive values and increases the overall level of risk (a sort of notching up). Conversely, in the opposite case (notching down).

Q6. Do you agree with the option to use either capital coverage ratio or Common Equity Tier 1 ratio as a measure of capital? Would you favor one of these indicators rather than the other, and why?

Yes. However, FITD has not full data evidence on capital coverage ratio and CET1 ratio.

Q7. Are there any particular types of institutions for which the core risk indicators specified in these Guidelines are not available due to the legal characteristics or supervisory regime of these institutions? Please describe the reasons why these core indicators are not available.

No.

Q8. Do you think that more guidance or specific thresholds should be provided in these Guidelines with regard to calibration of buckets for risk indicators, or minimum and maximum values for a sliding scale approach?

No.

EBA question related to the impact assessment

Q9. Do you agree with our analysis of the impact of the proposals in this Consultation Paper? If not, can you provide any evidence or data that would explain why you disagree or might further inform our analysis of the likely impacts of the proposals?

FITD is now working with the Italian time series data to perform an impact assessment, in order to verify the changes on the risk ranking of its member banks. Unfortunately, data are not available yet.

About FITD

The Interbank Deposit Protection Fund (FITD) was established in 1987 on a voluntary basis and become compulsory in 1996. As of 31 December 2014 FITD has 215 member banks and the total amount of covered deposits is 508 billion euro. FITD funding is ex-post and contribution of member banks is risk based. FITD assess the riskiness of its member banks on the basis of five financial ratios both on individual and consolidated basis.

FITD has a close working relationship with EFDI, IADI and many European and International organizations and academia, especially with the European Commission (EC).

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