European Association of Co-operative Banks
Groupement Européen des Banques Coopératives
Europäische Vereinigung der Genossenschaftsbanken

# EACB Views on Draft Guidelines on methods for calculating contributions to Deposit Guarantee Schemes (EBA/CP/2014/35)

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**Contact:**

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The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 3.700 locally operating banks and 71.000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 215 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 56 million members and 850.000 employees and have a total average market share of about 20%.
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The members of the EACB welcome the opportunity to comment on the EBA draft GL on methods for calculating contributions to DGSs.

Please find here below our answers to selected questions.

## 1. ***Answers to specific questions***

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

*Proportion core/additional indicators*

We consider the overall architecture of the draft GL solid, quite comprehensive and understandable. However, the GL should take a more progressive approach to flexibility. Especially the 75%/25% balance between core and additional risk indicators seems insufficient to take adequately into account various national specificities that may be presented. Moreover, it does not leave sufficient room for the compensation of any weaknesses that may become evident when the rules are put in practice. We understand that there has to be a trade-off between flexibility and comparability. However, we strongly believe that each national DGS should be able to reflect in an effective way the national particularities, the characteristics of the national banking sector, and the business and institutional environment. Thus, a different balance between core and additional indicators should be envisaged, e.g. 60%-40%, that would ensure an adequate level of homogeneity across Member States while allowing DGSs to have a sensible approach.

*The calibration of profitability indicators*

We strongly support the inclusion of business model and management as a component of the metric for calculating risk-based DGS contributions. However, it needs to be recognised that "profitability" is an ambiguous indicator, which has to be calibrated with greatest care. Cooperative and mutual banks, although profitable institutions, do not consider profit maximisation as a main goal. They are rather focused on sufficient, but steady profits. We therefore welcome the clarification in Annex 2 that such business models should not be penalised. We would welcome a solution that would encompass, for instance, a double calibration of the ROA on two different but comparable scales i.e. to reflect both profit-maximising and non profit-maximising business models. At the hearing the EBA suggested that the GL be modified to make explicit reference to the idea that member states adopt a double calibration method. We strongly support this idea and would encourage the EBA to amend the GL accordingly.

The Authority also suggested that a similar, dual calibration, method be adopted for the ratio of the return of risk-weighted assets over total assets, so as to accommodate fair treatment of banks which adopt the standardised approach, and would otherwise be unfairly treated vis a vis those on the IRB approach. We are very supportive of this idea and urge that the GL is amended to reflect it.

*Risk mitigation factor for IPS*

It seems that the risk mitigating role of Institutional protection schemes (IPSs) is too much focused on the amount of the IPS ex-ante funding (see para. 65). In addition, Art. 13(1) DGSD seems to remit to the Member States how to account for the risk mitigation role of an IPS, and thus to determine lower contributions. Indeed, an IPS typically foresees numerous other features that are decisive for risk mitigation and entails a broader notion, also for the purpose of supervisory approval, as provided under Art. 113(7) CRR. Recital 12 of the DGSD reiterates the liquidity and solvency function of the IPS already established under the CRR, and it recognises that IPS "*which protect the credit institution itself and which, in particular, ensure its liquidity and solvency. Where such scheme is separate from a DGS, its additional safeguard role should be taken into account when determining the contributions of its members to the DGS*". The wording of para. 65 of the draft GL could lead to the conclusion that the extent to which a single member of an IPS could benefit from a reduced contribution to the DGS depends exclusively on the (quantitative) level of the IPS ex ante funds. Hence, it would reduce the liquidity and solvency function played by an IPS to these funds and deviate from CRR. However, the risk mitigating factor of membership in an IPS is not only a result of the IPS ex ante funds.

Rather, other characteristics are decisive for the risk-mitigating effect of an IPS, reflected by the requirements set in Art. 113(7) of CRR (which the competent authority has to approve):

- The presence of early warning systems;
- Periodic reporting;
- An uniform risk assessment;
- A legal obligation and ability to grant support;
- Funding measures (i.e. the establishment of ex-ante IPS funds);
- Additional ad-hoc contributions by IPS members (if the ex-ante fund is empty);
- An homogeneous business profile of participating institutions;
- The production of annual consolidated/aggregated report.

Considering as predominant only one element of the IPS architecture seems therefore inappropriate.

*Concentration indicators*

We understood during the hearing that the concentration indicators mentioned in the GL should be considered only as an example for additional indicators and that they are not mandatory, consistently with what indicated in the Annex. We welcome this clarification and we believe that it should be inserted also in the text of the GL. In fact, it should be taken into account that the application of these indicators might create difficulties in Member States with strongly decentralised networks or in very small Member States.

*Development of the Banking sector*

More in general there would be a question of how to take into account and manage the developments of the banking sector (in terms of risks, deposit base, newcomers) to adequately assess the resources of the DGS.

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

We believe that the level of detail could be instructive when a new system needs to be established so that a whole "architecture" can be rolled out. On the other hand, the degree of detail would require significant modifications to established and accepted systems. This seems to be problematic due to a lack of validation of the method suggested by the EBA and the danger of a disproportionate assessment of risk and inappropriate reflection of risk profiles or business models. We therefore wonder whether a more principle-based approach would not be more appropriate, at least at this stage.

Art. 13(2) DGSD allows DGS to use their own risk based calculation methods (provided that they are approved by the competent authority). However, it is not clear how DGSs would be able to use/maintain their own calculation methods if there is one single calculation method proposed for all DGS. The margin left seems to narrow. In the light of the Directive there should be sufficient flexibility in the Guidelines for DGSs.

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

*IPSs that are recognised as DGSs*

The consultation addresses IPS (Para. 12, 64 ss. Annex) and provides solutions for considering them in the context of contributions to DGS. In fact, IPS according to Article 113(7), which ensure the solvency and liquidity of the adhering institution, take a different approach when it comes to contributions. They do not only have to protect the deposits, but the entire bank. Therefore they do not base each bank-specific[1] contributions on covered deposits as suggested by article 13(1) of the DGS Directive, but on all assets, i.e. the overall risk of the institution, especially RWA.

The draft guidelines do not reflect this to a sufficient degrees. Admittedly, there are suggestions for solutions but they do not provide the required solutions for "institutional protection schemes that are officially recognised as DGSs" (Article 1(2)(c) of the DGSD). Due to the division of labour in cooperative banking networks/groups there are specialized service providers, which dispose of very little deposits; e.g. a central institution with a balance sheet total of more than 200 billion € and covered deposits of only 97 million €, or a mortgage bank with a balance sheet total of nearly 35 billion and covered deposits of a negligible 68000 €. Moreover, among local banks there may be also be significant varieties due to the geographical situation or the different business models (e.g. only retail clients/private persons vs retail and corporate clients). These differences between covered deposits and risk-weighted assets are also a result of the division of tasks between local cooperative banks and central entities in a cooperative network[2]. Such division of tasks in cooperative groups and networks, especially regarding deposit-taking and the allocation of liquidity, is reflected also in EU legislation, most recently by

[1] Without any doubt the overall amount of the fund will be the 0.8% of the sum of all covered deposits of all members of the IPS
[2] The Member Associations will provide further data to EBA.

Article 16 of Regulation 2015/61 to supplement CRR with regard to the liquidity coverage requirement for Credit Institutions

The calculation formula in the EBA Draft GL does not allow to come to appropriate results, simply because the calculation base (covered deposits) is not appropriate. With regard to the division of tasks and the important varieties regarding covered deposits as explained above also the suggested adjusting factor "systemic role in an IPS" would never be sufficient to ensure an appropriate scaling because almost every institution within an IPS might be affected by changing the calculation base from RWAs to covered deposits.

Therefore, the current proposal does not meet the requirement imposed by article 13(2) of the DGSD that *"the calculation of contributions shall be proportional to the risk of the members and shall take due account of the risk profiles of the various business models".* Instead, the calculation of the contributions on the basis of the guidelines would lead to enormous unintended distortions and promote moral hazard. Contributions would be imbalanced to a degree that the existence of the system as such would be put in question.

We thus need to recall that Article 26 of Regulation 1093/2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, explicitly states that

*The Authority shall contribute to strengthening the European system of national deposit guarantee schemes […] and provide a high level of protection to all depositors in a harmonised framework throughout the Union, which leaves the stabilising safeguard role of mutual guarantee schemes intact, provided they comply with Union legislation.*

The EACB therefore asks the EBA should provide a solution, which allows for an appropriate reflection of the situation of IPS according to article to 1(2)(c) of the DGSD.

We finally wish to recall that there were good reasons why the legislator, when designing the DGS-directive, has finally chosen the legal instrument of "guidelines" as a tool to harmonize contribution systems for the various DGS, which in fact allows for more flexibility than any RTS or ITS. In our opinion, the ideal solution would therefore be a specific opt-out for IPS/DGS. If limited to IPS according to Article 1(2)(c) of the DGSD, such opt-out would remain limited to a well-defined number of cases.

*Contractual DGSs*

Also contractual DGSs, as recognised under Art. 1(2)(b) DGSD, require further fine tuning to allow the definition of meaningful contributions. Contractual DGSs are intended as DGSs of co-operative banking groups/networks including their central institutions (second level institutions), and which are also entitled with early intervention tasks. In particular, we believe that what mentioned above with regard to an opt-out for the calculation of contributions, would respond and correctly reflect also the capability of such schemes to properly assess the full profile of all member institutions. In fact, in order to avoid distortions in terms of contributions, second level institutions within these

schemes deserve a specific treatment. This is due to risk structure, balance sheet composition, business model specific division of tasks, etc. which can be managed efficiently only at national level (i.e. at network level). The opt-out shall be granted along the lines already mentioned above, to maintain its logic and applicability well defined and limited.

*Adjustment coefficient μ*

We welcome the introduction of the factor μ (adjustment coefficient) as an important element of flexibility, avoiding excessive contribution devolving resources from the economy during economic downturns, and allowing faster build-up of the DGS fund in economic upturns. However, its practical implementation requires more guidance for instance, on how to define an economic downturn or upturn. It is unclear how the business cycle adjustment would be compatible with reaching the target level as economic downturns normally last longer than a year. The term business cycle should also be clarified in its scope (meaning it refers to one country, a region, or overall in Europe, or the business cycle of the banking industry). It should also be considered that the business cycles of the banking industry is very much connected to the economic cycle, and that deeper lagging effects may be specific to business models. It should also be avoided that the factor μ is misused to postpone payments turning into a very high "balloon rate" at the end of the 10-year-build-up-period.

*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?*

With regard to risk intervals we believe that in general the specified range is acceptable, and would reflect institutions' differences. However it should be further clarified possibly providing examples, as mentioned in para. 43, that the values indicated are simply thresholds as there is no certainty regarding the allocation of a bank on the interval for a given year. In fact, in each Member State the interval chosen/used should result in an adequate differentiation among institutions, to ensure that there is a credible incentive to improve their risk profile and move across the interval.

Moreover, we believe that this range may be lowered for a country where banks' overall risk profile is fairly homogenous. In this regard, we would suggest that discretion is left to the competent authority to set the national range within the European boundaries on the basis of its own assessment of the banking sector risk profile.

*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?*

In our understanding of DGSD, the risk criteria used for the calculation of the contribution of a liable institution aim at assessing the likelihood of failure, or probability of using the deposit guarantee fund (DGF). Indeed, the riskier an institution is, the more this institution is likely to go bankrupt, and the more it may recur to the DGF;

consequently the more it has to contribute to the deposit guarantee mechanism. Nevertheless, we do not believe that the risk criteria retained by the EBA are appropriate to reach this goal.

Indeed, we believe that EBA risk criteria are too close to the ones of the Single Resolution Fund (hereafter "SRF") with respect to their definition as absolute criteria as opposed to criteria relative to a country's banking sector risk profile, and thus need to be more flexible. Therefore, DGS's core risk indicators should recognise already the existence of resolution mechanisms which would take over, at least in case of important or systemic crises, relevant elements of the protection brought by DGSs themselves. In this context, given the privileged ranking of covered deposits in the creditor hierarchy, the risk for a DGS to be called to important disbursements in resolution is reduced.

*Overreliance on balance sheet items*

With regard to core risk indicators for the category "Capital" there seems to be an overreliance on balance sheet items. More consideration for P&L-items with regard to early warning mechanisms, and other forward looking indicators could instead also be considered.

In fact, there seems to be a significant high correlation among the leverage ratio, the CET1 ratio and RWA/Total Assets ratio. In particular, overreliance on risk weighted assets and total assets respectively are yet to be stated, and these could as well be included within the category "Business model and Management". This would lead to a higher flexibility and a stronger focus to essential risk categories like the quality of management and internal governance arrangements.

Moreover, the experiences of some of our Member organisations show that models mainly based on profit and loss provide for a more valid prediction of the "problematic cases", rather than other balance sheet figures. At the same time we consider "profitability" an ambiguous indicator, which has to be calibrated with greatest care. Cooperative and mutual banks, although profitable institutions, do not consider profit maximisation as a main goal. They are rather focused on sufficient, but steady profits. We therefore welcome the clarification in the Annex that such business models should not be penalised. We would welcome a solution that would encompass, for instance, to have a double calibration of the ROA on two different but comparable scales.

*The treatment of IPSs that are not recognised as DGSs*

The EACB welcomes the recognition provided to Institutional protection schemes (IPS) in these draft GL by a specific factor. However, for cooperative banks, particularly those which are in the process of establishing an IPS or already use it, the proposed treatment appears to be quite difficult and parsimonious.

The difficulty lies in the fact that the recognition of IPS membership falls into the 25% of freedom that Member States are given to adjust the basic matrix. Thus, if this factor were granted a relevant weight, the room for other adjustments that are required due to national particularities or simply insufficiencies of the model provided by the guidelines

(which may become evident when tested in practice) would be reduced considerably. We therefore believe that this adjustment should not fall in the 25% category.

Moreover, from the current drafting the membership in an IPS seems a modest potential element of risk mitigation. The proposed treatment as an additional indicator in the risk category Business Model and Management does not reflect adequately its meaning for the risk profile of a member bank and the contribution to solvency and liquidity profile provided by the participation to an IPS.

We see that there are numerous clarifications regarding core risk indicators in different variants, on the other hand IPSs, that require homogeneous business model, the same risk assessment and other common elements of profound meaning as declined in Art. 113(7) CRR, are shortly addressed in Part IV.

In particular, as already recalled, the existence of means in the IPS-fund is only one of the several features that characterise an IPS and that are required for supervisory approval. Indeed such features as uniform systems for the monitoring and classification of risk and the possibilities to take influence, together with the implied system of early warnings and with reporting obligations, are essential to the risk mitigation role played by such schemes. In this sense, the GL should better reflect the substance of the provisions under Art. 113(7) CRR, and 13(1) DGSD which does not foresee any condition for the recognition of the role of IPSs.

At the heart of the IPS lays an "early warning system". This implies constant data gathering and on-going calculation of regulatory capital. The early warning system requires regular analysis and research based on a comprehensive internal reporting system which is constantly monitoring income and risk development. In case of minor variations, necessary measures are immediately taken.

Ad-hoc payments provide an additional safeguard. Any IPS member is legally obliged to grant other IPS members immediate support, beyond the contributions to the ex-ante fund. In case the ex-ante fund does not suffice to fulfil its objective, solvent IPS members will provide ad-hoc payments (to the extent that their own minimum capital requirements are fulfilled, this to avoid contagion effects).

According to Art. 113(7) CRR, national competent authorities have to pre-approve the IPS. Any approval of an IPS requires already a thorough analysis by the competent authority. Once the IPS is established the competent authority monitors on an ongoing basis whether all requirements of the IPS are met at all times.

We would therefore suggest to delete the reference to the ex ante funds. Alternatively, we would suggest to amend para. 65 of the Guidelines in order to take into account specific risk mitigating characteristics:

"The IPS membership indicator should reflect the additional solvency and liquidity protection provided by the scheme to the member, taking into account ~~whether~~ the amount of the IPS ex-ante funds ***and the extent to which members of the scheme are obliged to make (additional) ad-hoc payments***, which are available ~~without~~

~~delay~~ for both recapitalisation and liquidity funding purposes in order to support the affected entity in case of problems. ***These factors shall be*** sufficiently ***comprehensive*** ~~large~~ to allow for a credible and effective support of that entity. ***These*** ~~IPS funding~~ ***factors*** should be examined in relation to the total assets of the IPS member institution. ***Furthermore, when deciding upon lower contributions for IPS-Members the existence of a reliable early warning system and a uniform risk assessment in the IPS shall be taken into consideration, as these two instruments avoid bankruptcy of member institutions most effectively.*** ~~The level of the IPS funding should be examined in relation to the total assets of the IPS member institution.~~"

We believe that it would be appropriate to allow a more sensible weighting of IPS in the Aggregate Risk Weight, being a crucial and conducive element of final safety of IPS groups/networks, or to treat IPS more straightforwardly as core indicator to be used in calculation method by DGSs while dealing with IPS groups.

Finally, we understand that the provision for increased contribution for central institutions in virtue of their systemic role in an IPS should be applicable only for IPSs that are also DGSs as in that case the central institution would have a systemic importance for the DGS itself. We believe that this aspect should be clarified in the GL.

*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 favour one of these indicators rather than the other, and why?*

We believe that the CET1 ratio is a preferable solution, also due to the fact of being a commonly accepted ratio by market participants. In any case, the choice should be harmonised in each and every country in order to prevent cherry picking and/or moral hazard.

*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.*

The core risk indicators are generally accepted ratios. Thus for most banks they should be available. However, liquidity ratios will only have to be implemented by October 2015 and may thus not be commonly available by now. We understand that the use of proxies will be envisaged for the time being.

*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. We rather believe that a further level of specification could create, at least at this stage, more difficulties.

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| *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?* |

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