The Norwegian Banks' Guarantee Fund
Dronning Mauds gate 10
0250 Oslo
Norway

Date: October 30 2022

# Comments on Consultation Paper

## Draft Guidelines (revised) on methods for calculating contributions to deposit guarantee schemes under Directive 2014/49/EU repealing and replacing Guidelines EBA/GL/2015/10

The Norwegian Banks' Guarantee Fund (NBGF) would like to thank EBA for the work with revising the Guidelines on methods for calculating contributions to deposit guarantee schemes and the proposed changes.

We have reviewed the consultation paper and have some comments.
Our main comment is that we do not see merit in the level of the proposed minimum weights of the core indicators, as it may come at the expense of the bearing principle for calculating contributions as described in the DGSD (36) and DGSD Article 13 (2). Furthermore, the sample data which the analysis is based upon, is limited and it is not possible to make robust or empirical conclusions. We recommend a more thorough analysis of the consequences of the changes in minimum weights and its effects for each DGS. One should take into account the conformity between contributions and the risk incurred by each member. NBGF proposes a less complex method to avoid the sense of false precision which is based on a small data sample.

More detailed comments to the consultation paper are listed below. Based on these comments, NBGF have in conclusion proposed a new rule for setting minimum weights for categories of risk indicators and individual risk indicators. Please see "NBGF's proposal for minimum weights for core indicators".

In the last chapter NBGF has a remark to one of the formulas given in the consultation paper.

BANKENES SIKRINGSFOND
THE NORWEGIAN BANKS' GUARANTEE FUND

## Principle for calculating risk-based contributions (DGSD)

The principle of harmonization in the DGS Directive of deposit protection is essential to ensure a level playing field and financial stability. It is therefore reasonable to ensure a harmonized set of rules regardless of jurisdiction. For example, a harmonized coverage level and harmonized coverage per depositor and not per deposit. Furthermore, the DGS Directive (27) states that the financing of DGSs should be harmonized at a high level with a uniform ex-ante financial target level for all DGSs.

The DGS Directive emphasizes that DGSs should be able to use their own risk-based methods and that contributions to DGSs should be based on the amount of covered deposits and the degree of risk incurred by the respective member, according to DGSD (art. 36). Given the differences in national banking sectors and the proposed set of strict minimum rules for each risk indicator, this may reduce the conformity between contributions and the risk incurred by the respective member institutions for each DGS. The guidelines should allow for some flexibility for minimum weights to account for national and jurisdictional differences in banking sectors, to enable DGSs to comply with DGSD article 13 (2).

Another important issue when adjusting the minimum weights of the core indicators and keeping their sum at 75 %, is that for every justified increase, a corresponding and equal decrease also needs justification, and vice versa. If this is not the case, there will be a residual allocated to indicators that may not improve the model, even though the initial adjustment is justified. This also becomes evident when considering points 43. and 44. in EBA TFDGS 2022 06 (Discussion note on RBC), where in point 44 it is suggested to reduce the weight of the indicator RWA/Total assets to keep the 75 per cent total weight on the core indicators.

We understand EBA's point of view when it comes to harmonization of financing of DGSs at a high level with a uniform ex-ante financial target level for all DGSs. There should however be a balance between harmonization at a high level and the opportunity for each DGS to use their own risk-based method for determining and calculating risk-based contributions per bank.

Core indicators' explanatory power is uncertain and likely to differ between jurisdictions and over time. NBGF is of the opinion that each DGS should have sufficient flexibility to adjust the weights of core indicators in order to comply with the DGS Directive (36) and Article 13 (2). Thus, providing each DGS with the opportunity to develop fair, robust, stable and transparent contribution models for their members, and at the same time have the option to adapt the model according to national and jurisdictional differences. Hence the minimum weights cannot be too high as it will limit the flexibility.

## Sample of data

EBA staff have analyzed 39 DGS interventions and categorized them by reason for the interventions. When assessing the core indicators predictive values for DGS interventions, the sample is reduced to the 30 cases where ARS, ARW and core indicators were reported by the DGSs. The sample is limited, and one could argue that it is too small to make robust empirical conclusions[1]. It may seem contradictory to admit that the sample is too small to make robust conclusions on its basis and at the same time argue for changes to the minimum weights of core indicators.

For many jurisdictions the relevant sample is further limited when adjusted for the 19 credit unions not representative for them. EBA proposes to *"Adjust the minimum weights of the core risk indicators based on empirical evidence, to better reflect the indicators' performance in measuring the risk to the DGSs"*. Given that only five DGS's[2] in the study guarantee deposits from credit unions, and that CUs are subject to different national prudential requirements with regard to CRD/CRR, NBGF questions whether the DGS-interventions for credit unions should be included in the analysis. As a majority of the DGSs in EU are not exposed to any risk from credit unions, it could be argued that these 19 observations should have been omitted since conclusions drawn from them are irrelevant.

Furthermore, figure 11 and 12 in EBA TFDGS 2022 06 implies significant differences in the cause of DGS-intervention between CUs and non-CUs. A conclusion from this observation should be to develop separate guidelines for CU contributions and non-CU. Instead, CU observations are now affecting the conclusion for DGSs not exposed to this risk. Table 17 states that only 5 DGSs cover CUs, and of these, two are already using different methodologies in determining the contribution. The aimed harmonization in the revised guidelines seems to be at the expense of the quality and

[1] Also highlighted in EBA TFDGS 2022 06 (Discussion note on RBC), 23. first bullet-point.
[2] DGS' in the study that guarantee deposits from credit unions: [CZ, IE, LT, LU, PL]

relevance to the majority of DGSs due to the inclusion of CUs with demonstrated different characteristics, risks and business models. The inclusion of CUs in the sample data, and the fact that they are the main basis for the proposed changes, seems to affect the results and conclusions to a high degree as it represents 50 % of the intervention cases. Total CUs are only ~10 % of the total amount of non-CUs (table 14).

## Indicator for return on assets

In chapter 4.2.2. (32)[3], EBA-staff note that RoA seems to provide a very good indication of an increased likelihood of DGS interventions. Based on the findings in chapter 5.1.1 (89) [2], the reasons for interventions for credit unions are generally linked to solvency and profitability issues. But the reasons have been more diverse for non-credit unions in the sample. If we exclude CUs from the analysis, the argument that RoA provides good indicative value for DGS interventions is weakened.

Increasing the weight of RoA might have unintended consequences on the distribution of risk adjusted contributions. Based on our calibration of NBGF's risk-based contribution model against our liability model, we have not found that RoA provides a very good indicator of PD for member banks.  Member institutions with a low but positive RoA, are not necessarily high-risk institutions but may be the result of their business profile.

Furthermore, a high RoA can be an indication of a more excessive risk-taking business profile. This is further supported by the fact that three of the reporting DGSs reported a double threshold for RoA, where high levels (above 3 %, 4 % and 10 % respectively) were assigned an IRS of 100[4]. Increasing the weight of RoA from 6,5 to 10 % may therefore reduce the contributions from high-risk member institutions and increase contributions from low- medium risk institutions.

## Correlation between core indicators

Correlation between core risk indicators should be taken into consideration when adjusting their weights. Indicators that are highly correlated can be assumed to measure

---

[3] Source: TFDGS 2022 006. Discussion note on the survey results on risk-based contributions (RBC) – analysis, conclusions and policy proposals. 10 Marc 2022.
[4] EBA TFDGS 2022 06 (Discussion note on RBC) point 55.

much of the same underlying risk. The proposed new weights of both leverage ratio and CET1 ratio is 10 %. Which totals 20 % for capital core indicators. Several DGSs have observed that these two capital measures have a strong correlation. Based on the correlation analysis by the EBA, the indicators have a spearman correlation of 0,58[2].

Compared to other categories of core indicators, the capital risk indicators differ in that both are relatively highly correlated and that they have the highest allocation of percentage points. Based on our calibration of NBGF's risk-based contribution model against our liability model, we have not found that leverage ratio or CET1 ratio are very good indicators to capture the risk member institutions pose on the DGS.

Hence, NBGF recommends that their total weighting of 20 % should be reconsidered and perhaps be reduced.

## Core indicators predicative value for DGS interventions

A DGS is exposed to both the risk of a member institution failing to meet its obligations and regulatory requirements, which can lead to a DGS intervention, i.e. reimbursement of guaranteed deposits, and the potential loss for the DGS given a default of a member institution. The proposed weighting in section 4.2 (ii) is based on the core risk indicators' predictive value for DGS interventions. This limits the analysis to the indicators' predictive value for only the probability of default and does not capture the loss given default risk of a member institution. Currently, only one core risk indicator captures the loss given default risk (covered deposits / unencumbered assets). EBA finds that the indicator unencumbered assets / covered deposits does not provide an indication of DGS intervention.

Example: Consider two equal institutions, only differing in loss absorbing capital, i.e. capital held by the institution that is ranked below covered deposits in the credit hierarchy. The risk, defined as the expected loss to the DGS, could be argued to be very different in the two cases where the potential loss is also considered, whereas the probability of a DGS intervention could be the same.

Based on NBGF's calibration between the risk-based contribution model and our liability model, the covered deposits / unencumbered assets is a very good risk indicator for indicating both PD and LGD. Since this is the only risk indicator that directly measures the loss given default risk, NBGF proposes that the allowed minimum weight for risk indicator(s) grouped under *Potential loss for the DGS is increased from 12,5 to 15 %.* Note that the NPL- indicator also provides a measure for the loss given default risk. Therefore, NBGF also proposes the allowed minimum weight for risk indicator(s) grouped under *Asset quality to be increased from 12,5 to 15 %.*

## NBGF's proposal for minimum weights for core indicators

In conclusion, NBGF proposes to set the minimum weights as follows:

- DGSs must allocate a minimum of 15 percentage points to each of the five groups of risk indicators (*capital, liquidity and funding, asset quality, business model & management and potential loss for the DGS)*

- The sum of minimum weights totals 75 %

- DGSs must allocate a minimum of 5 percentage points to each of the core risk indicators

This proposal will allow for sufficient flexibility for each DGS to account for national and jurisdictional differences in banking sectors and enables each DGS to comply with DGS directive Article 13 (2), to ensure that contributions are proportional to the risk of the members and take due account of the risk profiles of the various business models.

| Indicator | Proposed minimum weights |
|---|---|
| **Capital** | **15,0 %** |
| Leverage ratio | 5,0 % |
| CET 1 ratio / capital coverage ratio | 5,0 % |
| **Liquidity and funding** | **15,0 %** |
| LCR | 5,0 % |
| NSFR | 5,0 % |
| **Asset quality** | **15,0 %** |
| NPL ratio | 5,0 % |
| **Business model & management** | **15,0 %** |
| TREA / Total assets | 5,0 % |
| RoA | 5,0 % |
| **Potential losses for the DGS** | **15,0 %** |
| Covered deposits / unemcumbered assets | 5,0 % |
| **Sum of minimum weights, grouped** | **75 %** |

*Table 1: NBGF's proposal to minimum weights of core indicators and groups of core indicators.*

## Comment to formula in the consultation paper

On page 17 in the consultation paper, the following formula is proposed:

40. For the sliding scale method, if the distribution of the ARS is such that no institution has an ARS close to 0 and/or 100 and hence a much smaller range of the ARS and consequently ARW would be used, DGSs may enhance the formula in the following way:

$$ARW_i = \beta * \left(\frac{\alpha}{\beta}\right)^{\left(\frac{ARS_i - \gamma}{(\delta - \gamma)}\right)}$$

Where:

$0 > \gamma > \delta > 100;$

$\gamma$ is the lower threshold of the ARS translating to the lowest ARW $\beta$; and

$\delta$ is the actual upper threshold of the ARS translating to the highest ARW $\alpha$.

NBGF asks whether the specification: $0 > \gamma > \delta > 100$,

Should be written as: $0 < \gamma < \delta < 100$.

Best regards,

Sonja Lill Flø Myklebust
Director
E-mail: firmapost@sikringsfondet.no
The document has been approved electronically