FINANCING OF THE SRF FROM A PRACTITIONERS PERSPECTIVE

BERLIN, 26.06.2019

Jeder Mensch hat etwas, das ihn antreibt.

Wir machen den Weg frei.

AGENDA

- **Some major characteristics of the Single Resolution Fund (SRF)**
- Contributions to the SRF and their development
- Key criticism
- Other inconsistencies in the regulatory framework/calculation methodology
- Future developments

SOME MAJOR CHARACTERISTICS OF THE SINGLE RESOLUTION FUND (SRF)

- The Single Resolution Fund (SRF) …
  - was established within the European recovery and resolution framework,
  - is “owned” by the Single Resolution Board,
  - is financed by the banks in participating member states (currently Eurozone) during an initial periode of eight years until 2023,
  - is according to the BRRD / SRMR used only for the purpose of ensuring the efficient application of the resolution tools and exercise of the resolution powers,
  - shall reach at least 1 % of the amount of covered deposits of all credit institutions authorised in all of the participating Member States (estimated € 65 billion).

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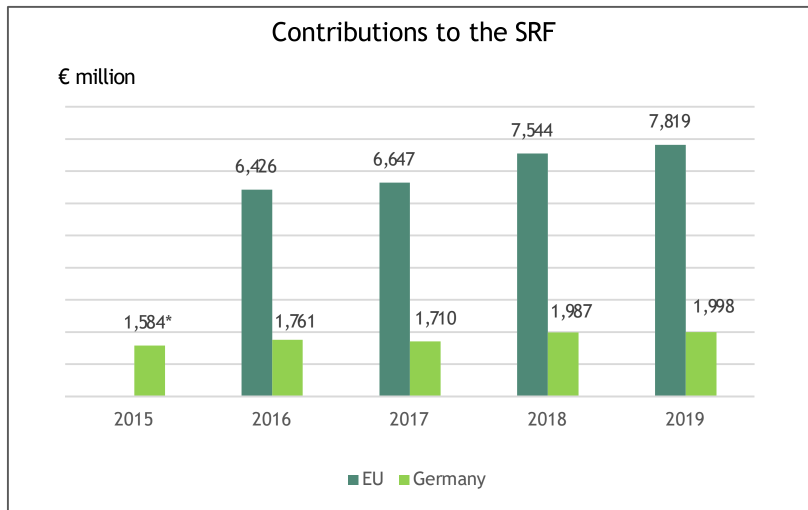
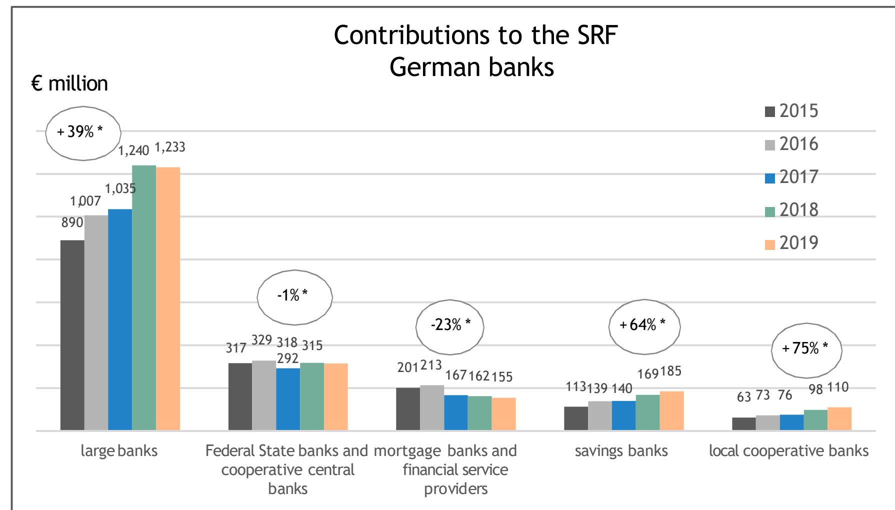
CONTRIBUTIONS TO THE SRF AND THEIR DEVELOPMENT (I)

- Institutions are grouped into three categories with regard to their contributions to the SRF:
  - Small institutions with total assets < € 1billion and a base amount (total liabilities – own funds – covered deposits) up to € 300 million qualify for a lump sum payment between € 1.000 and € 50.000.
  - Mid-size institutions with total assets < € 3 billion qualify for a partial lump sum payment. For the part of the base amount (total liabilities – own funds – covered deposits +- derivative adjustments – further deductions) < € 300 million the contribution is € 50.000 and for the amount higher € 300 million a risk adjusted amount is calculated.
  - For larger institutions with total assets > € 3 billion which do not qualify for lump sum payment the full amount of contributions is calculated on a risk adjusted base.

  - Even if larger institutions pay the largest part of the annual contributions, this does not mean that the amounts of small and medium sized banks are negligible. For example one of our small cooperative member bank with total assets of € 2.9 billion payed a contribution of around € 701.000 in 2019 .

CONTRIBUTIONS TO THE SRF AND THEIR DEVELOPMENT (II)





*Change from 2015 to 2019

- * Contributions in 2015 had been levied outside the SRF but subsequently transferred to the SRF and are deducted in eight equal parts from annual contributions of the institutions until 2023.
- The contributions of German banks increased by € 411 million (+26%) between 2015 and 2019.
- Local cooperative banks and savings banks with the highest relative increase from 2015 to 2019,
  - the contributions of the local cooperative banks increased by € 47 million (+75%);
  - the contributions of the savings banks increased by € 72 million (+64%).

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KEY CRITICISM

- According to Article 67(2) SRMR the “*Board shall use the Fund only for the purpose of ensuring the efficient application of the resolution tools and exercise of the resolution powers*”.
- However, there are institutions which would - in case of failing - not be resolved but liquidated (under application of national insolvency law). Such institutions include the nearly 900 German cooperative banks.
- As the resolution authority itself determined that such institutions will not be resolved, the question arises, why such (small, non-complex) institutions should contribute to the SRF. The SRF mainly serves as a resolution financing arrangement for bigger institutions.

→ Legal framework for “special levies” is ignored: Not all institutions are the beneficiary of the levy, so that the burden caused by the levy is not balanced by benefits allocated to the whole group. The levy does not really apply to a specific homogenous group of institutions.

→ There is in general an insufficient differentiation of institution-specific risk characteristics, e.g. resolved vs. liquidated institutions or membership in an IPS vs. (just) DGS.

→ It had been argued that smaller institutions benefit from financial stability in a general and the SRF contributes to that aim. But the last financial crisis had shown that in particular the small and medium sized German cooperative banks had been resilient to the crisis.

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OTHER INCONSISTENCIES IN THE REGULATORY FRAMEWORK/CALCULATION METHODOLOGY (I)

- Apart from the key criticism a number of more technical points show inconsistencies in the regulatory framework/calculation methodology.

- The following aspect is important for lump sum institutions:

  - Static vs. dynamic approach of lump sum qualification limits.

- For institutions with a partially or fully risk based contributions are inter alia important:

  - Adjustment of the weight of the individual risk pillars and risk indicators.
  - Calibration of bins (risk buckets) for individual risk indicators.

- Mergers of institutions lead to disproportionate contributions

OTHER INCONSISTENCIES IN THE REGULATORY FRAMEWORK/CALCULATION METHODOLOGY (II)

Static vs. dynamic approach of lump-sum qualification limits

- The legal approach of the lump sum contribution amounts is a static one, depending on fixed thresholds:
  - Total Assets < € 1 billion and
  - Basic Annual Contribution (total liabilities – own funds – covered deposits) ≤ € 300 million
- Due to natural growth of institutions and – also important – due to mergers of small institutions a dynamic approach or a regular upwards adjustment of the relevant parameters is necessary. Otherwise the (politically chosen) ratio of contributions between smaller and larger institutions is more and more unbalanced.

OTHER INCONSISTENCIES IN THE REGULATORY FRAMEWORK/CALCULATION METHODOLOGY (III)

Adjustment of the weight of the individual risk pillars and risk indicators (I)

Pillar	Indicator	Weight of indicators in Pillar	Weight of the Pillar
Pillar I: Risk Exposure	Own funds and eligible liabilities held by the institution in excess of MREL	25%	50%
	Leverage ratio	25%	
	Common Equity Tier 1 (CET1) Capital Ratio	25%	
	Total Risk Exposure divided by Total Assets	25%	
Pillar II: Stability and variety of Source of Funding	Net Stable Funding Ratio	50%	20%
	Liquidity Coverage Ratio	50%	
PILLAR III: Importance of an institution to the stability of the financial system or economy	Share of interbank loans and deposits in the European Union	100%	10%
PILLAR IV: Additional risk indicators to be determined by the resolution autority	Risk weighted assets for market risk divided by Total Assets	4,5%	20%
	Risk weighted assets for market risk divided by CET1	4,5%	
	Risk weighted assets for market risk divided by total risk exposure	4,5%	
	Off-balance sheet nominal amount divided by Total Assets	4,5%	
	Off-balance sheet nominal amount divided by CET1	4,5%	
	Off-balance sheet nominal amount divided by total risk exposure	4,5%	
	Derivatives exposure divided by Total Assets	4,5%	
	Derivatives exposure divided by CET1	4,5%	
	Derivatives exposure divided by total risk exposure	4,5%	
	Complexity and resolvability	4,5%	
	Membership in an Institutional Protection Scheme	45%	
	Extent of previous extraordinary public financial support	10%	

- Due to the unavailability of harmonised data, the SRB did not so far require the institutions to provide information on the data highlighted in red. Therefore the weight of the available risk indicators is rescaled proportionally (e.g. in Pillar I the Leverage Ratio, the Common Equity Tier 1 and Total Risk Exposure get each the weight 33,33 % in 2019).

- **Moreover the just minimal relevance of the membership in an IPS with a maximum amount of 9 % in the weight of Pillar IV can be seen. In addition the SRB divided member banks of an IPS into three subcategories which even lead to a further decrease of the contribution-reducing IPS-factor (adjustment factors of "1", "0,778" and 0,556").**

OTHER INCONSISTENCIES IN THE REGULATORY FRAMEWORK/CALCULATION METHODOLOGY (IV)

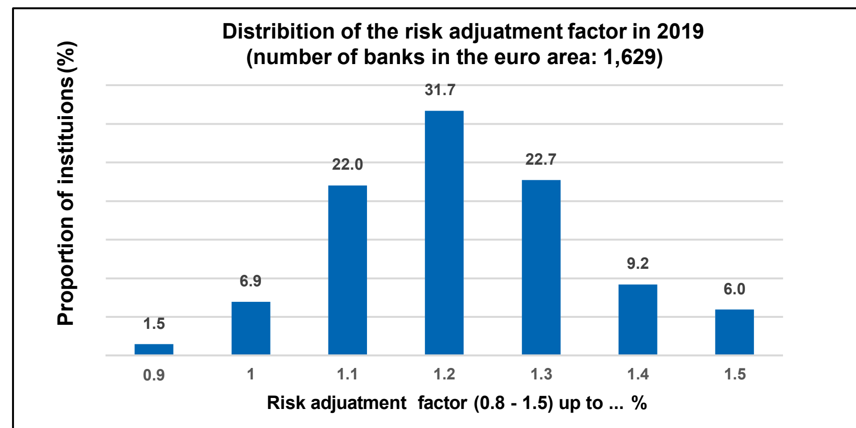
Adjustment of the weight of the individual risk pillars and risk indicators (II)

- In the area of risk pillar III ("importance of an institution to the stability of the financial system or economy") it would be consistent to deduct IPS-internal positions from the indicator "share of interbank loans and deposits in the EU". This would correspond to the treatment according to Art. 113(7) CRR which assigns a risk weight of zero to these positions.
- In addition also promotional loans (e.g. KfW) should be deducted from the indicator "share of interbank loans and deposits in the EU" (and in addition from the annual base amount). Otherwise such promotional loans would be penalized by contributions to the Single Resolution Fund.

Leaving these positions in the indicator would obviously overstate the actual risk.

OTHER INCONSISTENCIES IN THE REGULATORY FRAMEWORK/CALCULATION METHODOLOGY (VI)

Adjustment of the weight of the individual risk pillars and risk indicators (III)

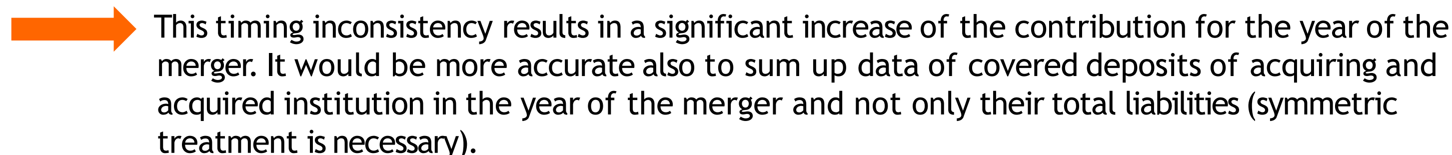


- The distribution of the risk adjustment factor falls approximately symmetrically. 77.7% of the institutions have received a factor from 1.0 to 1.3. The model system contains drivers that shift the distribution of the risk adjustment factor from both sides towards the mean value of 1.15.
- In this regard, the position of the institutions in the range of the risk adjustment factor is to the greatest possible extent pre-set, detached from an actual risk assessment and arbitrary. Such a distribution model is not based on the riskiness of institutions and thus questionable.

OTHER INCONSISTENCIES IN THE REGULATORY FRAMEWORK/CALCULATION METHODOLOGY (V)

Mergers of institutions: Inconsistency with regard to the deduction of covered deposits

- The basic contribution of an institution is calculated to the amount of its total liabilities excluding own funds and less covered deposits (and if applicable other positions, e.g. intra-group liabilities), whereby for the amount of covered deposits an annual quarterly average and for the other positions the status as of December 31 is relevant.
- In case of merger of institutions, the administrative practice of the SRB results in an disadvantage for the merged institution as parts of the covered deposits of the acquired institution cannot be deducted:
  - The merged institution has to report for contribution purposes its aggregated total liabilities.
  - The covered deposits of the acquired institution however can only deducted from total liabilities beginning with the quarter following the entry of the merger in the register.



This timing inconsistency results in a significant increase of the contribution for the year of the merger. It would be more accurate also to sum up data of covered deposits of acquiring and acquired institution in the year of the merger and not only their total liabilities (symmetric treatment is necessary).

OTHER INCONSISTENCIES IN THE REGULATORY FRAMEWORK/CALCULATION METHODOLOGY (VII)

Calibration of bins (risk buckets) for the indicators

- The bins for the risk indicators depend on the level of the whole population. Consequently, the best bins will be determined by extreme “outlier institutions”.
- The consequence of such a bin distribution is that in this model financially sound institutions that even significantly (over)fulfil regulatory and economic requirements find themselves in average or worse assessment bins. This can be demonstrated by the example of the Liquidity Coverage Ratio (LCR):

  - On December 31, 2017, the median LCR of all cooperative institutions in Germany was 161%. Most of the institutions (about 70%) had an LCR ratio between 100% and 200%.
  - But to reach the bin corresponding to the lowest risk (best classes) the institution need an LCR ratio of 300%.
  - Institutions with a good LCR ratio of 130% will be placed in the bin corresponding to the highest risk (worst class) in this model, which is not adequste.

- The best bin should be defined not by “outlier institutions” but by a value above the regulatory minimum.

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FUTURE DEVELOPMENTS

- The Single Resolution Fund is financed by banks in the euro zone during an “initial periode” of eight years until 2023.

- What will happen after the “initial period” ?

  - Will institutions be obligated to pay further on contribution to the SRF?
  - Will there be a break? Or will contributions permanently stopped?
  - Will the legal framework be reviewed?
  - Is there a tendency to favour the FDIC-model with an integrated deposit insurance and resolution fund?

- The commission intends obviously not to review the legal framework before the end of the “initial period” - after the end of the “initial period” and also in the context of the debate about EDIS the cards could therefore be reshuffled.