Methodology for Ex-Ante Funding Contribution Calculations – Banking Resolution and Recovery Directive

Gibraltar Resolution and Compensation Unit

October 2017

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List of abbreviations

BOE	Bank of England
BRRD	Banking Recovery and Resolution
BV	Base Value
CET1	Common Equity Tier 1
EBA	European Banking Authority
FSB	Financial Stability Board
FSRCC	Financial Services Resolution and Compensation Committee (“the Delegated Authority”)
GFSC	Gibraltar Financial Services Commission (“the Competent Authority”)
LCR	Liquidity Coverage Ratio
RCU	Resolution and Compensation Unit

Introduction

The principle purpose of bank resolution is to have:

- comprehensive and effective arrangements to deal with failing banks;
- co-operation arrangements to tackle cross-border banking failures; and
- to assist with ensuring long term financial and economic stability.

The BRRD is a large part of the financial sector reforms that have taken place since 2009 and is driven by the following FSB recommendations endorsed by G20, which has included:

- a “review of resolution regimes and bankruptcy laws in light of recent experience to ensure that they permit an orderly wind-down of large complex cross-border institutions";
- acting together to "...create more powerful tools to hold large global firms to account for the risks they take" and, more specifically, to "develop resolution tools and frameworks for the effective resolution of financial groups to help mitigate the disruption of financial institution failures and reduce moral hazard in the future";
- endorsement of the Financial Stability Board (FSB) Report on "Reducing the moral hazard posed by systemically important financial institutions" which recommended that “all jurisdictions should undertake the necessary legal reforms to ensure that they have in place a resolution regime which would make feasible the resolution of any financial institution without taxpayer exposure to loss from solvency support while protecting vital economic functions through mechanisms which make it possible for shareholders and unsecured and uninsured creditors to absorb losses in their order of seniority”; and
- endorsement of the Financial Stability Board FSB's core recommendations for effective resolution ("Key Attributes of Effective Resolution Regimes for Financial Institutions").

Effective resolution tools and powers requires a certain level of financing, with costs not being borne by the public. Directive 2014/59/EU therefore requires Member States to establish arrangements to raise funds for the effective implementation of resolution tools and powers. These financing arrangements are funded through ex-ante contributions from BRR firms.

The FSRCC is responsible for the calculations and collections of contributions in Gibraltar. The FSRCC applies the methodology set out in the Commission Delegated Regulation (EU) 2015/63 and the Council Implementing Regulation (EU) 2015/81, which ensures consistent and fair calculations rules for all BRR firms.

The BRRD fund will principally be used to cover the cost of resolving a failing or failed Credit Institution in Gibraltar. The ex-ante fund is held in a segregated account with the BOE, classified as a Special fund, which can only be used for intended purpose.

Contribution calculation stages

Gibraltar BRR firms are required to contribute to the ex-ante fund with calculations based on:

- the annual target level;
- the liabilities of a firm; and
- risk profile of a firm.

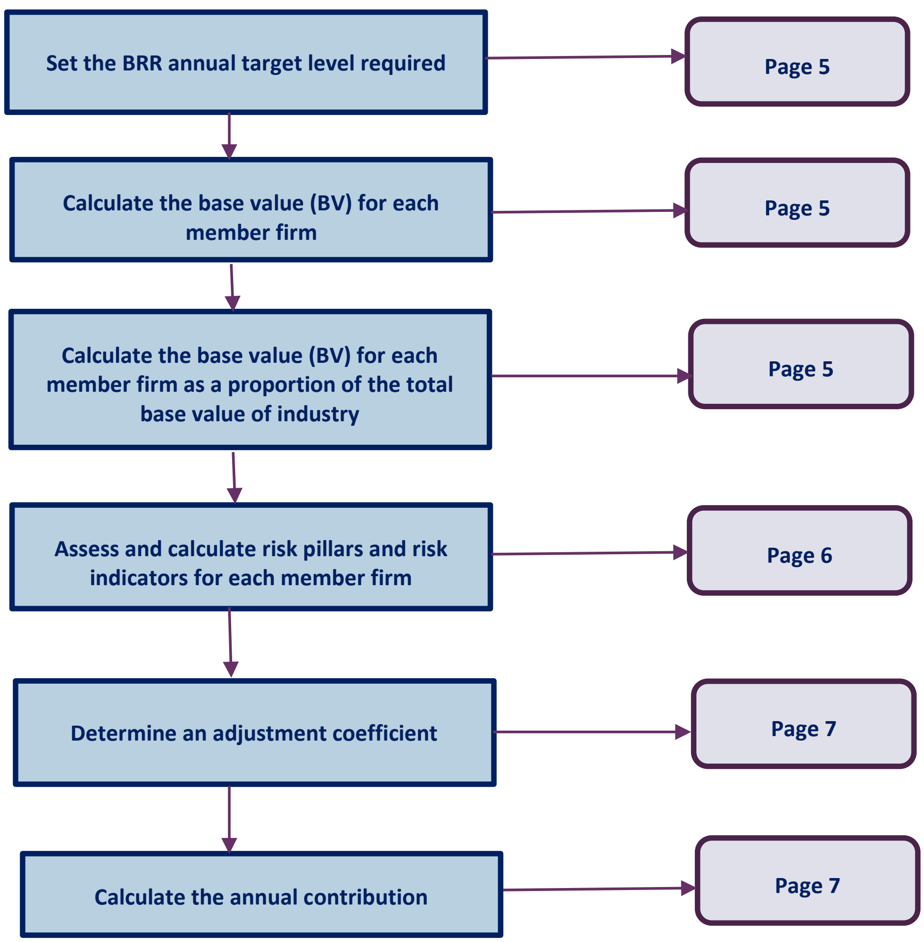
Where a BRR firm becomes newly supervised for only part of the contribution period, the contribution will be a pro-rated rate.

A change in status of an Institution during the contribution period shall not have an effect on the annual contribution to be paid in that particular year.

The calculation of ex-ante contributions is based on the latest available reported data available to the RCU. The required data for the calculation of contributions should not lead to excessive additional reporting requirements i.e. the RCU will make use of information already available to them or requested from the Competent Authority i.e. GFSC, as part of their reporting obligations. A balance is to be struck between requiring information necessary for the calculation of contributions and avoiding making unduly burdensome requests for information from Member Institutions. This has been ensured through the use of a data request template and associated guidance requested from the RCU to the GFSC.

There are a number of stages in calculating the contributions to the BRR Fund, as shown in Table 1 below:

Table 1: Stages of calculating BRR contributions



1. Set the BRR annual target level required

By 31 December 2024, the available financial means of the Gibraltar Fund needs to reach at least 1% of the amount of covered deposits of all BRR Credit Institutions authorised by the GFSC. The ex-ante contributions to the Fund will be spread out over time as evenly as possible until the target level is reached, taking into account the phase of the business cycle and the impact of pro-cyclical contributions. If the ex-ante funds are insufficient to deal with the resolution of an Institution, further contributions can be raised through ex-post contributions. Extraordinary ex-post contributions shall not exceed three times the annual amount of contributions.

Member States also have the discretion to extend the initial period of time for a maximum of four years, where certain criteria are met.

2017 workings (Gibraltar BRR ex-ante fund annual target level):

Covered deposits as at 31 December 2016: £1.194 billion

Target Level: 1% of £1.194 billion = £11.9 million

Amounts already collected in 2016: £1.2 million

Therefore: £12 million less £1.2 million = £10.7 million

Years remaining: 8 years

Therefore, **annual target level as at September 2017**: £10.7 million/8 years = **£1.3 million**

2. Calculate the base value (BV) for each member firm

A value is calculated representing the base/size of the member firm. This is calculated by:

Base/size of firm (BV) = Total liabilities - own funds – covered deposits – client assets*

**for investment firms*

2017 workings (BV for a Member Firm):

Total Liability of Firm A: £350 million

Own Funds of Firm A: £20 million

Covered Deposits of Firm A: £50 million

Client Assets for firm A (for investment firms): -

BV for Firm A = £280 million

3. Calculate the base value (BV) for each member firm as a proportion of the total base value for industry

2017 workings (BV for a Member Firm as a proportion of the total for industry):

Total BV of industry: £4 billion

BV for firm A (as above): £280 million

Proportion of industry total for firm A = 0.07

4. Assess and calculate risk pillars and risk indicators for each member firm

The RCU has assessed the risk profile of each BRR member on the basis of the following risk pillars and the underlying risk indicators:

1. Risk pillar 1 - Risk exposure
   Applicable risk indicators:
   - Leverage Ratio
   - CET 1 Capital Ratio
   - Total Risk Exposure divided by Total Assets

2. Risk pillar 2 - Stability and variety of sources of funding
   Applicable risk indicators:
   - LCR

When assessing the risk profile of each member, the RCU applies specific weights to each of the two pillars and the risk indicators within each pillar. The risk pillars and risk indicators used and the weights applied by the RCU are summarised in Table 2 below.

A firm's risk weighting score is calculated by comparing their risk indicators vis-à-vis other Gibraltar BRR firms, in line with Annex 1 of the Delegated Act.

Table 2: Risk Pillars and Risk Indicators

Risk Pillars	**Pillar 1. Risk exposure**			**Pillar 2. Stability and variety of sources of funding**
Risk Pillar Weight applied (total to equal 100%)	71%			29%
Risk Indicators within the risk pillars	**Leverage Ratio**	**Common Equity Tier 1 Capital Ratio**	**Total Risk Exposure divided by Total Assets.**	**LCR**
Risk Indicator Weight applied (total for each risk pillar to equal 100%)	33%	33%	33%	100%

5. Determine an adjustment coefficient

In order to ensure the annual target level is met and spread between firms, an adjustment coefficient is used. This will be different for each firm. This coefficient is calculated by applying the following, for each member firm:

Base value proportion (step 3 above) x risk value (step 4 above)

2017 workings (adjustment coefficient):

BV proportion of firm A: 0.07

Risk Value of firm A: 0.6

Adjustment Coefficient: 0.07 x 0.6 = **0.042**

6. Calculate the annual contribution

The annual contribution per member firm is then calculated by:

Member firm adjustment coefficient (step 5) as a proportion of the industry total coefficient x annual target level (step 1)

2017 workings (Annual contribution):

Adjustment coefficient for firm A: 0.042

Total adjustment coefficient for industry: 1.14

Adjustment Coefficient as a proportion of industry total: 0.042/1.14 = 0.0368

Annual target level: £1.3 million

Annual contribution of firm A (prior to any administration fees): £1.3 million x 0.0368 = **£47k**

Administration Fees

In addition to the BRR contribution, as detailed above, an administration fee will also currently be charged to firms.

The admin fee and the ex-ante contribution are required for two different purposes:

- Ex-Ante Fund contribution: The BRRD fund will principally be used to cover the cost of resolving a failing or failed Credit Institution in Gibraltar.
- Administration fee: The running of the BRR regime for the Gibraltar BRR firms. Given the nature of the work carried out, and given that there are no costs that are forecasted to be directly attributable to any specific firm(s), total costs are evenly spread amongst BRR firms.

The FSRCC is focused on running a cost effective model for the functions under its remit and the BRR framework is deemed to be very much at their infancy both in Gibraltar and across similar jurisdictions. Administration fees will include an estimate for salaries for the resourcing of the Resolution and Compensation Division (2017: two individuals) and any legal advice and professional fees. Any unused revenue from administration fees will be held as a reserve by the FSRCC, which is distinctly separate from the GFSC.

Union Branches

No guidance on contributions from 3rd Country Branches will be provided from the EBA. This area is therefore currently being developed by the RCU, in conjunction with numerous discussions with other jurisdictions, with a decision to be made on how to take this forward. Finalisation of this area may, or may not, have an impact on future BRR contributions.

Summarised working example

The following example is provided for illustrative purposes:

Firm A BRR Calculation (Calendar Year 2017)											
Step 1	Step 2					Step 3	Step 4	Step 5	Step 6		
Annual target level £	Liabilities £ (A)	Own funds £ (B)	Covered deposits £ (C)	Client Assets* £ (D)	Base/size of firm £ (E = A-B-C-D)	"E" as a percentage of total BRRD firms% (F)	Risk weighting score (G)	Adjustment Coefficient (H = F*G)	Annual Contribution £ (I)*	Admin Fee £ (J)	Annual Contribution £ (K= I+J)
1.3m	350,000,000	20,000,000	50,000,000	-	280,000,000	0.07	0.60	0.042	**47,000**	**7,000**	**54,000**

**For investment firms*

Industry total: £4 billion

Industry total: 1.14

£100k (in line with prior year) split between all firms - same for all firms

** I = H/Adjustment coefficient industry total x Annual Target Level*