Banking Rule BR/18

Risk-Based Method and the Compensation Contribution Method under the *Depositor Compensation Scheme Regulations (S.L. 371.09)*

CONTENTS

REVISIONS LOG

VERSION	DATE ISSUED	DETAILS
1.00	2016	Implementation of the EBA Guidelines ([EBA/GL/2015/10](#))
2.00	2024	Implementation of the EBA Guidelines ([EBA/GL/2023/02](#))

Introduction

1.   In terms of regulation 42 of the Depositor Compensation Scheme Regulations (Subsidiary Legislation 371.09) ("the Regulations"), issued under the Banking Act (Chapter 371 of the Laws of Malta) ("the Act"), the competent authority (the "Authority") is empowered to issue Banking Rules ("the Rules") to credit institutions as may be required for the purpose of carrying into effect any of the provisions of the Regulations. The Authority may also amend or revoke such Rules. The Rules and any amendments or revocation thereof shall be officially communicated to credit institutions and the Authority shall make copies thereof available to the public.

2.   The Rules must not be construed to be solely a substitute for a reading of the Act or of the Regulations themselves and shall be read in conjunction with the Act and the Regulations. The responsibility for observing the law rests entirely with the credit institutions and the relevant individual persons concerned.

Scope and Application

3.   In accordance with regulation 25(4) of the Regulations, the Authority shall, by Banking Rules, establish a method for determining the degree of risk incurred by members of the Depositor Compensation Scheme (referred to as "the risk-based method"), and a method for determining the amount of Compensation Contribution due by each member in each calendar year (referred to as "the Compensation Contribution method").

4.   The Banking Rule BR/18 on the Risk-Based Method and the Compensation Contribution Method ("the Rule") applies to all credit institutions licensed under the Act and is based on the 'EBA Guidelines on methods for calculating contributions to deposit guarantee schemes under Directive 2014/49/EU repealing and replacing Guidelines EBA/GL/2015/10' (EBA/GL/2023/02).

Definitions

5.   For the purpose of this Rule, the definitions contained in regulation 2 of the Regulations shall apply, and:

"Adjustment Coefficient" shall have the meaning assigned to it in regulation 25(6) of the Regulations;

"Risk-Adjusted Contribution" means the value of the cumulative Compensation Contribution by member 'i' in a given calendar year, excluding the adjustment coefficient;

"Year of Assessment" means the calendar year when the Compensation Contribution is due.

Regulatory Reporting

6.   In terms of regulation 25(7) of the Regulations, every member shall, in the manner required by the Authority, provide to the Authority the information specified in the fourth column (Sheet Number & Cell Reference) of Table 1 in Annex 1 of this Rule.

7.   A member shall be deemed to have complied with the requirement of paragraph 6 of this Rule when it has submitted to the Authority the information specified in the fourth column of Table 1 in Annex 1 in the data exchange formats and representations specified by the Authority, pursuant to and as part of the requirements established under Commission Implementing Regulation (EU) 2021/451 laying down implementing technical standards with regard to supervisory reporting of institutions and/or Regulation (EU) 2015/534 on reporting of supervisory financial information, as applicable (commonly referred to as the COREP and FINREP requirements), and pursuant to regulation 22 of the Regulations requiring credit institutions to submit to the Depositor Compensation Scheme their aggregate deposits data as at the end of each quarter of a calendar year by completing and submitting Schedule LD7.

8.   The Authority shall determine the Aggregate Risk Weight of each member (ARW) on the basis of the information submitted by each member pursuant to paragraphs 6 and 7 of this Rule.

Specifications as to the Calculation

9.   The Authority shall determine the ARW of each member by using (i) the risk indicators in the first column (Risk Categories & Core Risk Indicators) of Table 1 in Annex 1 of this Rule, (ii) the methodology specified in the section of this Rule entitled 'Calculating the Aggregate Risk Weight (ARW)', and (iii) the Sliding Scale Method outlined in Annex 2 of this Rule.

10.   For the purpose of calculating the ARW of each member, the Authority shall use the data as at 31 December of the calendar year immediately preceding the year of assessment. For the purpose of the Return on Assets risk indicator (item 4.2 in Table 1 of Annex 1), the value shall be determined using the data of the two financial years immediately preceding the year of assessment in the manner specified in Annex 1 of this Rule.

        Where covered deposits are held in a currency other than Euro (€), the amount of covered deposits shall be calculated on the Euro (€) equivalent of such covered deposits.

11.   The risk indicators shall be calculated on an individual basis, except as provided in paragraph 12 of this Rule.

12.   The risk indicators shall be calculated on a consolidated basis if the Authority has granted a waiver in terms of Articles 7 and 8 of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions, provided that as a result of said waiver, the data at the individual level is not available to the Authority.

Weighting of Risk Indicators

13.   The Authority shall determine the risk weighting (IWj) applied to each risk indicator of a member (ARW) in accordance with the fifth column of Table 1 in Annex 1 of this Rule.

Calculating the Aggregate Risk Weight (ARW)

14.   The Authority shall determine the Individual Risk Score (IRS_j) for each risk indicator A_j, in accordance with the Sliding Scale methodology specified in Annex 2 of this Rule.

15.   For the purposes of determining the Average Risk Score (ARS) for each member, the Authority shall multiply the IRS determined for each risk indicator by the risk weight applicable to that risk indicator, according to the following formula:

$$ARS_i = \sum_{j=1}^{m} IW_j \times IRS_{ij}$$

Where:

'IW_j' is the indicator weighting of each risk indicator;

'IRS_j' is the Individual Risk Score of each indicator;

'm' is the total number of risk indicators which in this case is 8; and

$\sum_{j=1}^{m} IW_j = 100\%$.

16.   In determining the ARW_i of each member, the authority shall use the following formula:

$$ARW_i = \beta * \left(\frac{\alpha}{\beta}\right)^{\left(\frac{ARS_i}{100}\right)}$$

Where:

'ARSᵢ' shall refer to the value calculated in accordance with paragraph 15 of this Rule. The ARS of an institution 'i' can take any value between 0 and 100;

β = ARW(0), i.e. the desired ARW value corresponding to an ARS value of 0 (lower limit); and

α = ARW(100), i.e., the desired ARW value corresponding to an ARS of 100 (upper limit).

Method for Calculating the Compensation Contribution

17.   The method for calculating the cumulative Compensation Contribution due by each member in every calendar year shall be the following:

$$C_i = CR \times CD_i \times ARW_i \times \mu$$

where:

C_i =   Periodic contribution from member '*i*';

CR =   Contribution Rate (identical for all members in a given period);

CD_i =   the total covered deposits (excluding temporary high balances) for member '*i*';

ARW_i =   the Aggregate Risk Weight for member '*i*'; and

μ =   the adjustment coefficient (identical for all members in a given period)

18.   The Authority shall determine the adjustment coefficient 'μ' in accordance with the following formula:

$$\mu = \frac{\sum_{i=1}^{n} CD_i}{\sum_{i=1}^{n} ARW_i * CD_i}$$

CD_i = the total covered deposits (excluding temporary high balances) for member '*i*'

ARW_i = the Aggregate Risk Weight for member '*i*'

19.   The Depositor Compensation Scheme should determine the Contribution Rate at least annually. The Contribution Rate for a given period shall be calculated as follows:

$$CR = \frac{Period\ Target\ Level}{\sum_{i=1}^{n} CD_i}$$

Entry into Force

20.   This Rule shall be deemed to have entered into force on 3rd July 2024.

ANNEX 1
Risk Indicators

Table 1 shows the risk indicators used to determine the ARW of each member.

Table 1: Risk indicators and weighting

Risk Categories & Core Risk Indicators	Indicator reference/Description	Formula	Sheet Number & Cell Reference [Template, Row, Column]	Risk Weight (IW)
Capital				**28%**
1.1 CET 1 (Common Equity Tier 1) Ratio	'CET1 ratio as stated in Article 92(2)(a) of Regulation (EU) No 575/2013' 'Total risk exposure amount' as stated in Article 92(3) of Regulation (EU) No 575/2013	$\dfrac{CET\ 1\ Capital}{Total\ Risk\ Exposure\ Amount}$	$C\_01.00, R0020, C0010$ $C\_02.00, R0010, C0010$	14%
1.2 Leverage ratio	Leverage Ratio as stated in Article 429 of Regulation (EU) No 575/2013	$\dfrac{Tier\ 1\ Capital}{Total\ Assets}$	$C\_01.00, R0015, C0010$ $F\_01.01, R0380, C0010$	14%
Liquidity and Funding				**21%**
2.1 LCR (Liquidity Coverage Ratio)	LCR as stated in Article 412 of Regulation (EU) No 575/2013	Liquidity Coverage Ratio (%)	$C\_76.00, R0030, C0010$	8%
2.2 NSFR (Net Stable Funding Ratio)	NSFR as defined in Article 428a-428az of Regulation (EU) No 575/2013	Net Stable Funding Ratio (%)	$C\_84.00, R0220, C0040$	13%
Asset Quality				**15%**
3.1 Non-Performing Loans (NPL) ratio	NPL ratio as specified in point (ii) of subparagraph (g) of Article 11(2) of Commission Implementing Regulation (EU) 2021/451[1]	$\dfrac{Total\ Non-performing\ loans\ and\ advances}{Total\ gross\ loans\ and\ advadnces}$	$F\_18.00, R0070, C0060$ $F\_18.00, R0070, C0010$	15%

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[1] Commission Implementing Regulation (EU) 2021/451 of 17 December 2020 laying down implementing technical standards for the application of Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to supervisory reporting of institutions and repealing Implementing Regulation (EU) No 680/2014**.**

Business Model & Management				**17%**
4.1 Total Risk Exposure Amount (TREA) / Total Assets	'Total risk exposure amount' as stated in Article 92(3) of Regulation (EU) No 575/2013	$\dfrac{\text{Total Risk Exposure Amount}}{\text{Total Assets}}$	$\dfrac{C\_02.00, R0010, C0010}{F\_01.01, R0380, C0010}$	8%
4.2 RoA (Return on Assets)	This is calculated on a 2-year period and averaged. Every quarter profit figures are accumulated up until the quarter before the financial year end. Once a new financial year restarts the profit figures are reset. Therefore, for the profit, a moving sum calculation is adopted to treat every quarter individually. For Total Assets, this is calculated by averaging each quarter for 2 years and outputting one value.	$\dfrac{\text{Profit or }(-)\text{loss for the year}}{\text{Total Assets}}$	$\dfrac{F\_02.00, R0670, C0010}{F\_01.01, R0380, C0010}$	13%
Potential losses for the DGS				**15%**
5.1 Covered deposits / Unencumbered Assets	'unencumbered assets' as defined in Article 411(5) of Regulation (EU) No 575/2013.	$\dfrac{\text{Covered Deposits}}{\text{Unencumbered Assets}}$	$\dfrac{LD7\ E24}{F\_32.01, R010, C060}$	15%
TOTAL				**100%**

ANNEX 2
Sliding Scale method to calculate the IRS

As per paragraph 14 of this Rule, an IRS_j is attributed to each risk indicator A_j for each member 'i'. For the indicators having an upper (a_j) and lower (b_j) boundary the IRS is determined by using a 'sliding scale method'. The IRS is assigned to the indicators ranging from 0 to 100, where 0 indicates the lowest risk and 100 indicates the highest risk.

When a higher indicator value indicates a higher risk and the indicator is above the upper boundary 'a_j', the value of the IRS is set at 100. Similarly, when the indicator's value is below the lower boundary 'b_j', the value of the IRS is set at 0. For values between the lower and upper boundary, the IRS_j value is set between 0 and 100 according to the formula below:

$$IRS_{ij} = \begin{cases} 100 & if\ A_{ij} > a_j \\ 0 & if\ A_{ij} < b_j \\ \frac{A_{ij}-b_j}{a_j-b_j}\ x\ 100, & if\ b_j \le A_{ij} \le a_j \end{cases}$$

where

j = indicator 'j', ranging from 1 to 'm'; and

'A_{ij}' is the value of the risk indicator for member 'i'.

Analogously, if a lower indicator indicates a higher risk and the indicator is below the lower boundary 'b_j', the value of the IRS is set at 100. Correspondingly, when the indicator value is above the upper boundary 'a_j', the value of the IRS is set at 0. For values between the lower and upper boundary, the IRS_j is set between 100 and 0 according to the formula below:

$$IRS_{ij} = \begin{cases} 0 & if\ A_{ij} > a_j \\ 100 & if\ A_{ij} < b_j \\ \frac{a_j - A_{ij}}{a_j - b_j}\ x\ 100, & if\ b_j \le A_{ij} \le a_j \end{cases}$$

where

j = indicator 'j', ranging from 1 to 'm'; and

'A_{ij}' is the value of the risk indicator for member 'i'.

The upper and lower boundaries of each risk indicator are listed in Table 2 below.

Table 2: Risk indicator boundaries

Risk Indicators	Upper Boundary (a_j)	Lower Boundary (b_j)
CET1 Ratio	14%	7%
Leverage Ratio	4%	3%
LCR	120%	100%
NSFR	120%	100%
NPL Ratio	10%	5%
TREA / Total Assets	60%	35%
RoA	1.5%	0%
Covered Deposits / Unencumbered Assets	200%	100%