RECOUPMENT CAPACITY OF THE EUROPEAN BANKING SECTOR TO THE SRF AND THE CB

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Introduction

- Resolution Case(s) → Resolution Tools
  - Single Resolution Fund (SRF): 52 bn EUR
  - If SRF not sufficient → Common Backstop (CB): Size of CB = size of SRF
- Common Backstop provided by the ESM: Loan (3 or 5 years maturity)
- Recoupment Capacity: “Can the banking sector repay the CB and the replenishment of the SRF within the foreseen timelines?”
- Repayment capacity: Recoupment capacity plus other cash flow sources
- Joint Project ESM and SRB

Building blocks: Recoupment capacity

Macroeconomic scenarios

- Baseline scenario
- Adverse scenario

Quantitative approach

- Econometric model based items
- Assumption based items

Contributions

Allocation of the ex-post and ex-ante contributions to refill the SRF and repay the common backstop

Projections

Projection of main banks' BS and P&L items over 3 to 5-year horizon

Contagion effect

Multiple simulated shocks and distress propagation

Final assessment

Impact on income generation and capacity of banks to make contributions to the SRF within a given period of time (3Y and 5Y)

Profit and Loss projections

The **quantitative approach** is founded on **econometric model-** and **assumption-** based items

ECONOMETRIC MODEL BASED ITEMS	To estimate the econometric model based variables, **macroeconomic** and **financial** explanatory variables were selected according to their economic relevance and following existing literature.
	
	• **Variables estimated:**
	  • Net Interest Income
	  • Fee & Commissions
	  • Loan Impairment Charges
	  • NPL ratio
	
	• **Addressing non-linearities:** panel quantile regressions with bank fixed effects.
	
	• **Addressing business model specificities:**
	Regressions are run by bank type (GSIB vs non-GSIB according to EBA classification)

ASSUMPTION BASED ITEMS	• Operating Expenses • RWA • Dividend distribution • Tax Rate

Contagion

Simulating shocks and tracking domino effects to the other financial institutions within the financial system.

CONTAGION MODEL

- Financial crises are modelled through a micro simulation portfolio model: Systemic Model of Bank Originated Losses (SYMBOL). SYMBOL incorporates contagion effects using a bank by bank correlation matrix
- We apply the SYMBOL model with a **correlation matrix** based on banks' equity returns (time-varying).
- Correlation Matrix decomposed into Common Factors: Faster simulation

The outcome are simulations of a ***distressed banking system*** *with banks that are failing/likely to fail.*

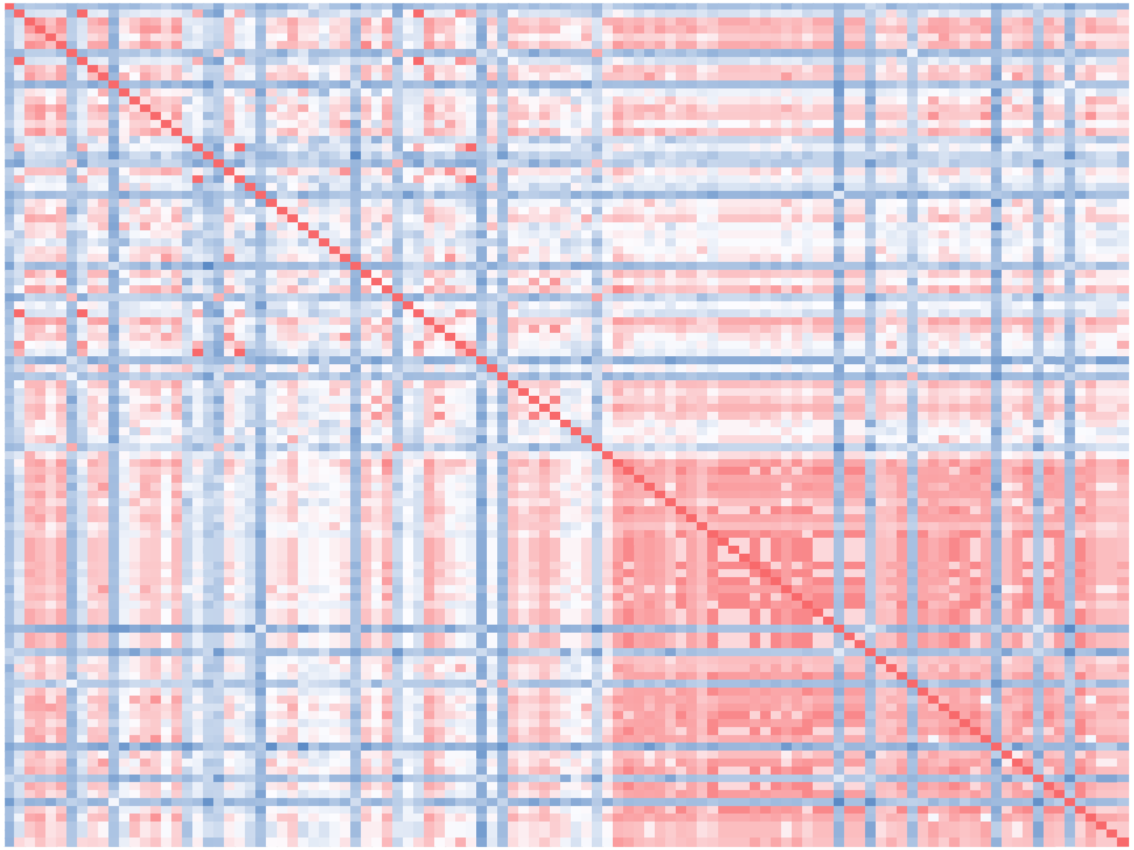
SHOCKS

- Selection of runs depending on use of Common Backstop:
  - Safety Net implementation
- Losses attributed to final assessment
  - Defaulted banks: capital surplus: max(0,TRC - 10.5%RWA)
  - Non-defaulted banks: SYMBOL simulated loss

The outcome are losses that reduce the banks' capital levels

Scope & Correlation Matrix

- Public available data
- Scope: 107 Institutions
- Correlation matrix estimated on stock returns
  - Circa 50 banks are listed
  - Non-list banks: Average correlation between country index and listed banks



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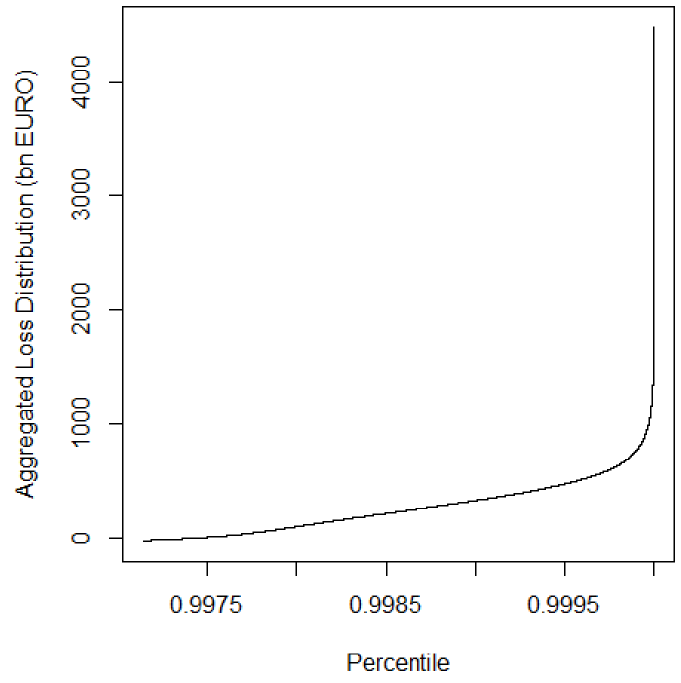
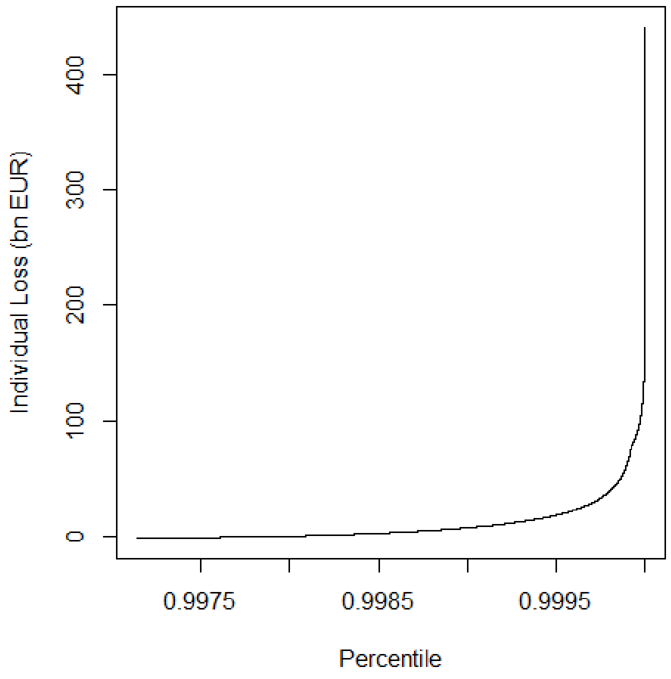
SYMBOL OUTPUT

- Circa 72 million runs simulated
- 300.000 runs with a simulated default: Loss > Total Regulatory Capital (TRC)
- Aggregated loss vs Individual loss





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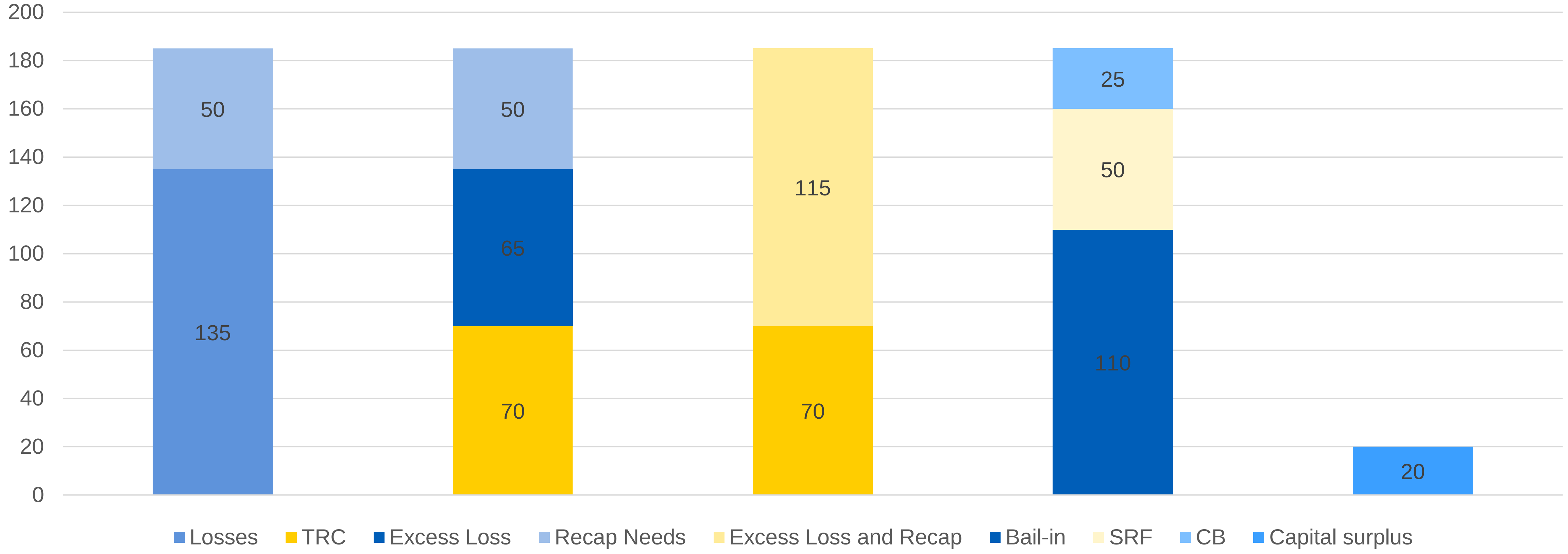
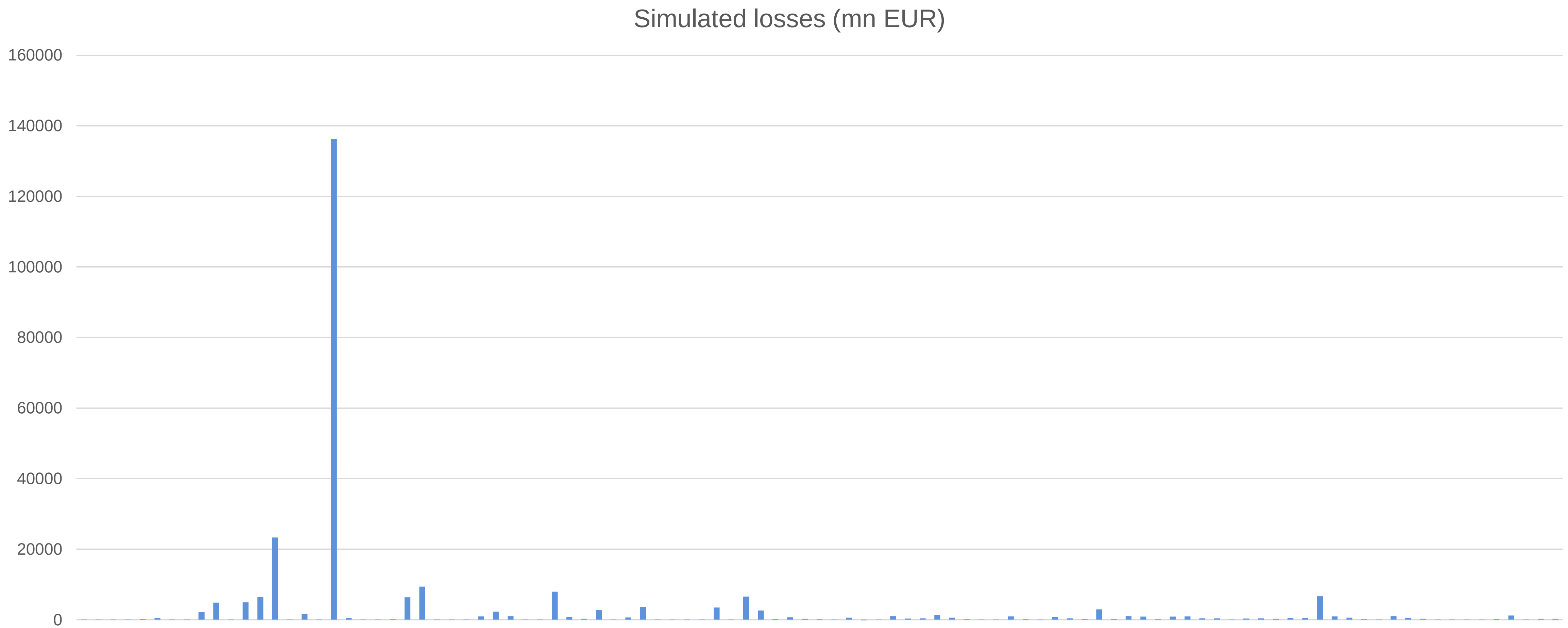
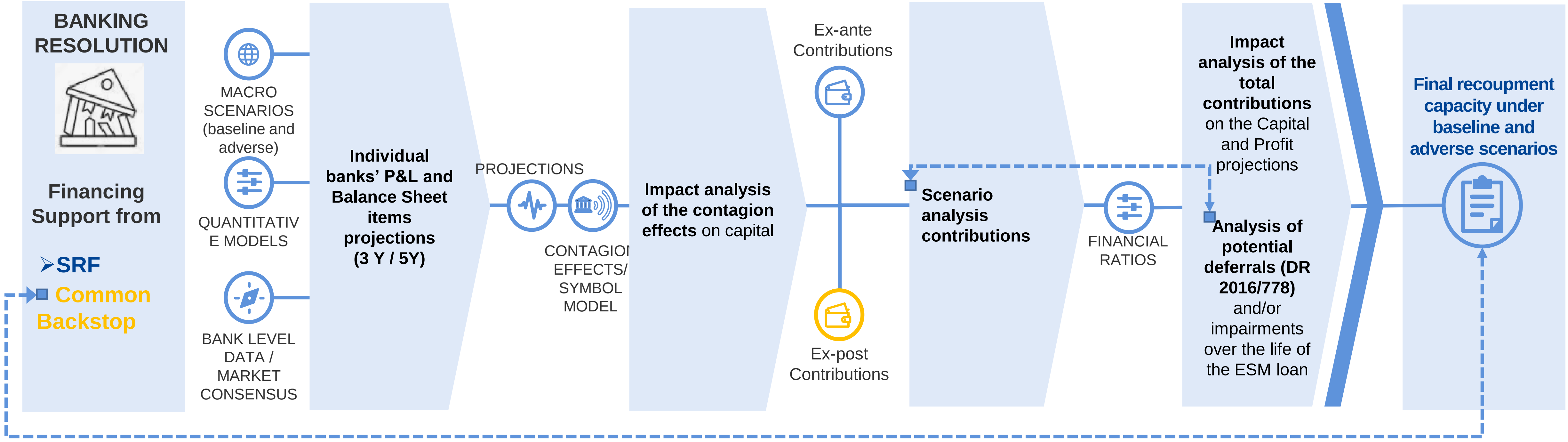
Safety Net Example: Use of CB for 25 bn



Losses generated by SYMBOL



Final Assessment: Integration of building bocks



Conclusion

- Different application of SYMBOL within the Recoupment capacity
- Changes to SYMBOL model
  - Adjustment of correlation matrix & Common Factor simulation
- Difficulties related to the integration with other models (blocks):
  - Macroeconomics scenarios
  - Econometric forecast of P&L
  - SYMBOL losses
    - Timing of losses

THANK YOU!

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