Request for comments

Banks methodological cycle - August 2019

Rating-Agentur Expert RA GmbH invites market participants to provide comments on the proposed changes in the Methodology of assigning Credit Ratings to Banks (hereinafter – Methodology). During the Methodological Committee Meeting held on the 6th of August 2019 a package of changes in the Methodology was discussed and approved by the independent members of the Advisory board which will lead to the following changes in the public version of the Methodology:

1) **We propose to update following factors in the Methodology to increase accuracy of the current banking sector risks estimation. These factors are aggregated into five factor groups.**

   Factors removed due to the low level of significance:
   - *Bank concentration (%)* under the **Market Conditions**
   - *Wastefulness of government spending* under the **Economic Factors**
   - *Total reserves minus gold (current US$) to GDP (current US$)* under the **Funding**

   Factors removed due to the data availability or calculation difficulties:
   - *Private credit by deposit money banks to GDP (%)* under the **Credit Conditions**
   - *Private credit by deposit money banks to GDP (%) growth* under the **Credit Conditions**
   - *Liquid assets to deposits and short term funding (%)* under the **Funding**
   - *Bank Z-score* under the **Funding**

   Factors moved to another group:
   - *Additional stress factors. Presence of a major crisis* moved under **Adjustment factors**
   - *Bank non-performing loans to gross loans* (%) under the **Market Conditions** moved under the **Credit Conditions**

   Newly introduced factors:
   - *Domestic credit provided by financial sector to GDP (%)* under the **Credit Conditions**
   - Reflects the amount of financial resources provided by domestic financial institutions as a share of GDP. A higher level of domestic credit provided by financial sector to GDP indicates a developed banking sector in an economy. However, a very high value of this metrics may also indicate an unsustainable increase in leverage, and therefore a higher banking sector risk
   - *Domestic credit provided by financial sector to GDP (%) growth.* Under the **Credit Conditions**
   - Reflects annual growth of previous factor in p.p.
   - *Bank concentration (%) growth.* under the **Market Conditions** Reflects concentration growth on the three largest banks and it helps us to assess whether the system direction towards a monopoly, an oligopoly or diversification
   - *Customer deposits to total loans (%)* under the **Funding**. The ratio reflects ability of the banking system to attract alternative source of funding with a lower risk of a sudden withdrawal. Hence, a higher value of the indicator decrease the overall score

- *ROE volatility* under the **Funding**. The score captures profitability and stability of a country's banking system. A higher standard deviation of ROE indicates a higher banking sector risk and hence negatively contribute to the banking sector aggregate
- *Property price to income ratio* under the **Economic Factors.** The variable assesses property purchase affordability. The higher the ratio, the higher risks in real estate market and worse BSR score

Rationale:

During the review of the BSR score, we noticed that several indicators, mainly sourced from the World Bank, are not available for recent years or not updated on a regular basis. Therefore, such indicators had to be substituted. We selected indicators that better describe banking sector risk, updated on a regular basis and easy in calculation using alternative sources. The source of new factors mainly will be WB, IMF, Numbeo Cost of Living database, Central banks of the observed country. In addition, factor *Bank concentration (%)* has been changed to its growth rate *Bank concentration (%) growth,* since it performed better in the model.

2) **We propose to change the weights of the group of factors according to the new importance level of each factor in the group in the determination of the banking sector risks.**

List of factors group for the assessment of the Banking Sector Risk (BSR)

Factor	New weight	Current weight
Credit Conditions	24%	25%
Market Conditions	26%	26%
Funding Conditions	10%	15%
Institutional Framework	22%	15%
Economic Factors	18%	13%

Rationale:

Changing the factors (listed in point 1) requires recalibration of the overall BSR model. Newly obtained statistical coefficients have a direct impact on importance of the indicator, hence in the group.

Please submit your comments to: info@raexpert.eu or compliance@raexpert.eu by the 6th of September 2019. Your response to this consultation will be published unless confidentiality is requested.