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From:	Secretary-General of the European Commission, signed by Ms Martine DEPREZ, Director
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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union

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Subject:	Annex to Commission Delegated Decision (EU, Euratom) .../... supplementing Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council with detailed conditions for the calculation of the effective provisioning rate of the common provisioning fund

Delegations will find attached document C(2020) 7684 final - ANNEX.

Encl.: C(2020) 7684 final - ANNEX



Brussels, 12.11.2020
C(2020) 7684 final

ANNEX

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to

COMMISSION DELEGATED DECISION (EU, Euratom) .../...

supplementing Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council with detailed conditions for the calculation of the effective provisioning rate of the common provisioning fund

ANNEX

1. The effective provisioning rate of the common provisioning fund shall be calculated taking into account the amount of expected and unexpected losses for each contributing instrument and the diversification ratio, which accounts for the correlation between the contributing instruments' losses, as set out in the following formula:

$$EPR_t = \frac{\sum_{i=1}^N EL_{i,t} + x_t * \sum_{i=1}^N UL_{i,t} * DR}{\sum_{i=1}^N EL_{i,t} + x_t * \sum_{i=1}^N UL_{i,t}}$$

Where

EPR_t – the effective provisioning rate, expressed as a percentage of the amount of the resources foreseen for the payment of the guarantee calls for the year t , if the provisioning for contributing instruments were held and managed separately;

$EL_{i,t}$ – the expected loss for the compartment i , for the year t , determined by the authorising services for the relevant compartment and representing the amount of resources that is necessary to meet expected guarantee calls for the year t ;

$UL_{i,t}$ – the unexpected loss for the compartment i , for the year t , determined by the authorising services for the relevant compartment and representing the volatility (standard deviation) of the expected loss for the compartment;

i, j – the compartment $\overline{1, N}$;

t – the year $\overline{1, T}$, where T represents the total lifetime of the relevant compartment;

x_t – the adjustment coefficient, expressed as percentage of $UL_{i,t}$ for the year t , reflecting the margin necessary to cover the short term volatility of the loss estimates, providing additional protection against insufficient liquidity;

$\rho_{i,j}$ – the correlation matrix between the individual compartments' losses over the lifetime of the contributing instruments;

DR – the diversification ratio, reflecting the difference between the sum of the lifetime unexpected losses of all the contributing instruments in the denominator and the lifetime joint unexpected losses for all the compartments, calculated as follows:

$$DR = \frac{\sqrt{\sum_{i=1}^N \sum_{j=1}^N UL_{i,T} UL_{j,T} \rho_{i,j}}}{\sum_{i=1}^N UL_{i,T}}$$

2. The diversification ratio shall be calculated by the financial manager for the year t , based on the inputs from the authorising services and correlation matrix estimates.
3. The correlation matrix between the compartments shall be determined by the financial manager, using historical data when available, proxies for the compartments using publicly available data (such as bond, equity indices) that represent the geographic or sectoral coverage for the respective compartments. The correlation matrix may be adjusted by the financial manager to take into the account market conditions and other relevant factors.