Brussels, 8th July 2020

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**EACB comments on EBA draft RTS on the prudential treatment of software assets under Article 36 CRR
amending Delegated Regulation (EU) 241/2014 supplementing CRR with regard to regulatory technical standards for Own Funds requirements for institutions
(EBA/CP/2020/11)**

General comments

The EACB welcomes the opportunity to comment on the draft EBA RTS on the prudential treatment of software assets under Article 36 CRR as amending Delegated Regulation (EU) 241/2014 (RTS own funds).

In fact, European banks continue to be at a disadvantage compared to other jurisdictions and industries. Being able to adequately accompany increased digitization of the banking industry is and will be a key element for financial stability. This will also be relevant to sustain and improve profitability.

We appreciate that the EBA is seeking to design an approach that is as simple as possible and close to the accounting perspective. At the same time we believe that certain aspects of the calibration of the amortization mechanism should be improved.

We would also recommend that, in light with the recently adopted CRR quick fix package, as a response to the effects of the COVID 19 pandemic, the adoption of the RTS can be as expedite as possible. However, in order to take into account possible delays a (potentially) retrospective application of the requirements as of September 30, 2020 could be envisaged.

Answers to specific questions

Question 1: In case some software assets are classified within tangible assets in your institution, what are the main reasons for doing so and what is the percentage of this classification compared with the classification as intangible?

As far as members have reported, software assets are generally not classified as tangible assets, however for some it might be a relevant issue.

At the same time, a reason that could lead to classification as tangible assets is compliance with IAS 16 in conjunction with IAS 38.4 if the software is an integral part of the hardware. In addition, according to IAS 38.8, there is an intangible asset if it is a clearly identifiable, non-monetary asset without physical substance. However, if an asset combines tangible and intangible components, it is up to the company's discretion to determine which component is to be assessed as essential. If software is now identified as an integral part of the associated hardware, it does not constitute an intangible asset in its own right. IAS 38 is therefore not relevant. Rather, the software in this case is not clearly identifiable and separable, but part of the material component and accordingly recognized as property, plant and equipment in accordance with IAS 16.

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Question 2: Do you have any comment on the proposed approach for the prudential treatment of software assets?

Software has become a core asset for banks' business models globally. Given the different treatment of software across jurisdictions, including cases of capitalisation of software as a tangible asset in financial statements, and consequential non-deduction from CET1, the use of the accounting value provides appropriate safeguards to ensure that depreciation leads to prudent valuation of the asset. Full depreciation is equivalent to capital deduction as it impacts the profit and loss accounts, and therefore retained earnings and CET1. Furthermore, the use of the accounting value is justifiable, verifiable (by auditors), simple and comparable.

We would also flag, that while the revised prudential treatment of software is meant to be simple to implement and applicable to all institutions in a standardised manner, it would require developing the IT solutions for calculating the prudential amortisation and combining the result with the accounting amortisation for each intangible asset. As banks have a large number of software assets and certain software assets undergo several improvements, the complexity of the task at hand should not be taken lightly. The current deduction treatment, albeit penalizing, is a straightforward addition using a value already available for accounting purposes. For banks using the standardized approach for credit risk, the proposed CET1 deduction would be a cumbersome exercise. For many small banks it would be uneconomical to implement such approach.

The effort to implement the proposed approach is associated with operational hurdles for small and medium-sized institutions. We propose a simplification in the identification of the possible software assets. The investment schedule shows the current write-up to the software. Small and medium-sized institutions are likely to use the write-up amount as the basis for determining the amount of the write-down. The write-up amount would be amortized over the regulatory useful life of two years. This means that small and medium-sized institutes no longer have to identify each individual piece of software, which makes the operational requirements considerably easier. This data is already available today.

We thus warmly recommend to simplify the proposed approach further. Another example could be the setting of a deduction weight or factor in a manner alike to risk weights or the SME supporting factor. It could also be useful to retain as an option at the discretion of the banks, i.e. for those that assess as too costly to implement the new approach in light of the type and size of their software assets and efforts to implement the new approach, to retain the deduction from CET1.

Question 3: What is your view on the calibration of the prudential amortisation period?

The calibration of the amortization period on a 2-year time horizon is in our opinion too short. Most software assets have a useful life of approximately 6 years. The prudential amortization period should be adjusted accordingly.

Indeed, in the DP the 2 years prudential horizon would be derived taking into account a study of EU takeovers involving institutions in the event of settlement, bankruptcy and liquidation. The EBA indicates a migration period for software of 1 to 3 years by which software would normally have been migrated to the purchaser's IT systems.

In our view, such time horizon must be seen as an average time required to migrate the entire software portfolio to the acquiring bank rather than a maximum of observed time for software migration. Members have indicated that experiences clearly show that software can continue to be used over a longer period in the event of a takeover and also in the event of liquidation (up to 8 years). In addition, in the case of a single takeover, the useful life of the individual software products transferred is not uniform. As a starting point, an approach of 2 years of useful life for supervisory purposes would not be appropriate.

As already illustrated by the EBA in the consultation paper, an amortization set on a short horizon has a negative impact on large-scale software and IT infrastructure investments that have a longer useful life. These investments could contribute to improving the competitiveness and resilience of the EU banking sector and would thus contradict the objectives of the EBA in this context.

Additionally, it is important to note that an implementation of a short amortization period leads to a negative impact on banks which have started to make a huge portion of their software investments early on. As these early adapters are leading markets developments, they should rather be encouraged. To the contrary, the envisaged amortization timeline punishes banks which have been ahead of the curve and invested in their software at an early stage.

Question 4: What is your view on the proposed alternative approaches illustrated above?

We would favour option B. Only an aligned treatment between prudential and accounting amortization can be implemented in existing systems. Any diverging prudential amortization process could only be implemented with a forward-looking perspective as for existing software these approaches have not been considered and therefore no data is available.

In both cases, there would be a need to set up subledger accounting. However, option B differ is much easier to implement as the data points required (original book value, current book value, start of depreciation) would mostly be already available. In addition, this would provide better comparability with accounting / FinRep.

When applying option B, in order to keep it simple and avoid unreasonable changes in CET1, the capitalisation of assets prior to amortisation should not be deducted from CET1, as otherwise it would be first deducted, then non-deducted, and finally deducted again.

Question 5: If considered needed, please provide any complementary information regarding the costs and benefits from the application of these draft RTS.

Further simplification would be needed for the implementation to be economically reasonable for many small banks. Please refer also to our answer to Q2.

Question 6: If considered material, please provide your own estimate on the difference in the impact of prudential amortisation treatment between (i) assuming the capitalisation date of software assets as the starting point for prudential amortisation (ie. Option A illustrated in this CP) and (ii) assuming the date of accounting amortisation as the starting point for prudential amortisation, but fully deducting from CET1 items the costs capitalised until this date is (i.e. Option B illustrated in this CP).

NA

Question 7: Please provide any additional comments on the Consultation Paper.

The level of application of the RTS is not always clear. Proposed Art. 13a (2) is talking about institutions. While in Art. 13a (4) there is a distinct treatment for software assets acquired from an undertaking. More clarity on which level of recognition this shall be effective would be welcome. Our understanding would be that this is effective on all levels of (sub) consolidation.

As indicated under Q2, it would also be useful for those institutions that have hardly capitalized software assets, and for which the implementation of the prudential amortization approach would not be commensurate with the capital savings, to maintain the option to use CET1 deduction.

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