Associazione Bancaria Italiana

ABI Response to Consultation Paper EBA/CP/2024/05 on Technical standards for the new Business Indicator framework for operational risk

May 2024

POSITION PAPER

2024

General remarks

We heartily welcome these technical standards aimed at clarifying how the business indicator component should be calculated.

We agree on this approach of using FinRep items for the construction/definition of the Business Indicator (BI). However, in some cases, even if the FinRep item reference is present, we ask that it be used only partially for reporting certain components that are not shown in the official EBA reporting framework (for example the leasing assets component or, more generally, the operational risk component, which is not defined from an accounting or supervisory point of view).

In order to avoid misunderstandings or wrong interpretations, we ask for more clarifications on properly identifying which kind of item or data has to be considered from an accounting and supervisory point of view. With these clarifications, it will be possible to establish whether (i) the item requested for the BI calculation is **available** in the official supervisory reporting or in the accounting systems, or (ii) if it is not available and has to be requested with a **specific data collection** (this can be a further effort for banks also in terms of costs and reconciliations), or (iii) if it is not an accounting or supervisory item but a **managerial item** that has to be managed differently (in this case the current link to FinRep item has to be revised).

The ABI offices through the competent working groups also contributed to the drafting of the Position Paper that was prepared within the European Banking Federation.

Question 1: What are your views on the proposal for the ILDC component? Please explain and provide arguments for your answer.

As reported in the general comments, the mapping of the ILDC component requires the identification of the "**assets leasing component**" in the FinRep items. Clarification would be greatly appreciated on the indications in terms of references to this phenomenon, and what is meant by "leased assets" that are not currently clear in the FinRep reporting framework. Given the previous request, it would be more appropriate to use the **internal accounting** system to identify the "assets leasing component".

We believe that within the Asset Component, the following elements should be considered as "leased assets":

• leases in which the institution is a lessee, falling within the scope of IFRS16;
• operating leases where the institution is the lessor and therefore the asset continues to be represented under its own balance sheet items.

Consequently, with regard to the related items included in the IC, the following **inclusions** would **not** seem **applicable** as they typically relate to financial credits, including the financial lease in which the bank is a lessor:

• the "Modification gains or (-) losses", net of financial leasing contracts where the institution is a lessor;
• the "Impairment or (-) reversal of impairment on financial assets not measured at fair value through profit or loss" relating to financial leases in which the institution is a lessor.

Question 2: What are your views on the proposal for the Services component? Please explain and provide arguments for your answer.

As reported in the general comment, the mapping proposed is not clear; it requires the identification, in the FinRep item, of the only component connected to the operational risk. We refer to the mapping of "**Other operating expenses**" for the following items Finrep: F02.00_r0370 (due to operational risk and not due to leases); F02.00_r0380 (due to operational risk); F02.00_r0390 (due to operational risk). For this information, the only reliable **source** is the operational risk losses database.

Article 16, point 2, reports: "For the purposes of point (d), the losses, expenses, provisions, and other financial impacts due to operational risk events shall not be net of any related payments received from insurance or reinsurance policies purchased". Please confirm that it is **possible to net off** payments other than those received from insurance o reinsurance policies purchased.

When comparing the list of items as per the Draft RTS "for the components of the BI under Art. 314(6) of the CRR", Art. 7 (Following: RTS list) with the list of items as per the Draft ITS "on the mapping of the BI components with corresponding supervisory reporting under Art. 314(7) of the CRR" (Following: ITS list) we noticed that the *RTS list* does not include the item "**fee and commission income**

from loan commitments given" (which is included in the ITS list, mapped with F22.01r0200_c0010 FINREP item). Should this item be included also within RTS list?

With reference to the calculation of **Other Operating Income**, Article 16 of the RTS does not explicitly exclude from the calculation of the Business Indicator **recoveries of expenses on behalf of customers** (stamp duty, substitute tax and other recoveries), although Article 314 para. 5 point d) provides for such an exclusion (see also answer to Q5).

Regarding the calculation of **the Fee & Commission Expenses,** which requires the inclusion of outsourced financial service expenses, entered in field F02.00_r0360_c0010 ("Administrative expenses"), we ask you to clarify the nature and type of financial services that qualify for inclusion in the Fee & Commission Expenses.

Question 4: What are your views on the proposal for the specification of the items to be excluded from the BI? Please explain and provide arguments for your answer.

The proposal for the specification of items to be excluded from the BI should be amended as follows:

"The exclusions referred to in Article 314(5) Regulation (EU) No 575/2013 shall be applied as follows:
a) for the purposes of Article 314(5) point (a) of the Regulation, income and expenses resulting from the distribution of insurance or reinsurance products or services manufactured or provided by an insurance company falling outside of the scope of Directive (EU) 138/2009 shall not be excluded from the calculation of the business indicator".

<u>Rationale</u>

The proposed specification of the items to be excluded from the BI introduces an undue burden on banks' capital requirements, causing them to lose their risk-sensitive attribute (driving unexpected loss quantification beyond confidence levels for banks adopting a fee-based business model) and introducing very high volatility on changes in expected T1 MRC, as testified by most recent QIS studies.[1]

[1] See for instance EBA/REP/2023/32, Chapter 5

From a systemic point of few, operational risk capital charges aimed at covering unexpected losses arising from insurance or reinsurance products and services is already fairly set aside by EU-based insurance companies falling within the scope of the Solvency II Directive.

From a bank's specific point of view, under the new standardized approach, the service component of the Business Indicator is now defined as the maximum amount between "Fee Income" and "Fee Expenses", while in the current methodology the same component is given by Net Fee margin. Considering the fact that the distribution of insurance products lowers operational risk more than the distribution of financial products because of their very nature of protecting customers' unforeseen events, we see the proposed change as an effective way of redressing the unlevel playing field caused by excessive MRC volatility, while leaving unchanged the original Basel 3 goals in a reviewed current framework.

Question 5: What are your views on the proposed mapping of the BI items to the FINREP cells? Please explain and provide arguments for your answer.

Interest income *(Article 1 of the RTS on BI items)*: we agree with the mapping proposed. For the leasing component required to be shown in the mapping, as it is not shown clear in the FinRep reporting framework item mentioned, we will use the available information in the accounting system (for example FR_45.03 row 010 column 010 only from leased assets).

Interest expenses *(Article 2 of the RTS on BI items)* we agree with the mapping proposed. For the leasing component required to be shown in the mapping, as it is not shown in the FinRep reporting framework item mentioned, we will use the available information in the accounting system (for example FR_45.03 row 010 column 020 only from leased assets).

The elements "Modification gains or (-) losses, net" and the "Impairment or (-) reversal of impairment on financial assets not measured at fair value through profit or loss" will not be considered as related to financial leasing where the bank is the lessor as indicated in Question 1.

Asset component *(Article 3 of the RTS on BI items):* further clarifications about two items are requested:

1) *"fair value of all derivatives classified as financial assets at the reference date for the calculation of the asset component, as long as such derivatives have earned/borne interest during the financial year that has been recognized as*

interest income or interest expenses; both trading and economic hedges and hedge accounting shall be included".

According to the instructions and other similar European reporting, **it is not correct to map all derivatives on the trading side, only the ones connected to the Interest Rate Risk.** This information is available in the following FinRep items:

- FR_10.Derivatives - Trading and economic hedges row 010 or 020 column 010

2) *"carrying amount of tangible assets and intangible assets subject to lease".* There is no clear correlation between the mapping for the asset component that refers to FinRep templates F21 and F42 (assets subject to lease) and the service component mapping that includes, in the operating income and expenses, also the changes in FV of the assets not subject to lease.

Dividend component *(Article 4 of the RTS on BI items)* we agree with the mapping proposed. No questions.

Other operating income *(Article 5 of the RTS on BI items)* we agree with the mapping proposed but in the elements to be excluded from the business indicator as proposed by Article 16, there are no comments on point c) (i.e. "recovery of administrative expenses including recovery of **payments on behalf of customers**") of Article 314(5), which is very relevant for Italian Banks. The relative amounts are included in FINREP in sheet F.45.03 row 40 and column 10.
These amounts must be excluded from the business indicator, so the proposed mapping to FINREP of the point b) "income from other income" of the proposed Article 5 "Other operating income" must not be to the entire amount of F.45.03 row 40 column 10, but only to this item after having excluded recoveries of administrative expenses and payments on behalf of customers.
In more detail, Italian Banks report in this item the amount of indirect taxes or expenses paid on behalf of clients, which are registered in the profit and loss account of the year in the FINREP F.02.00 row 370 and columns 10.
We therefore propose mapping point b) "income from other income" of Article 5 to F.45.03 row 40 column, but only after having excluded "recovery of administrative expense including recovery of payments on behalf of customers".

Other operating expenses *(Article 6 of the RTS on BI items):* the only issue is the identification of the operational risk component that is not shown in the FinRep Items and the missing clarifications from the accounting and supervisory point of view. In particular, we refer to: F02.00_r0370 (due to operational risk and not due to leases); F02.00_r0380 (due to operational risk); F02.00_r0390 (due to operational risk); for this information the only reliable **source** is the operational risk losses database.

Fee and commission income *(Article 7 of the RTS on BI items)* we agree with the mapping proposed, excluding the distribution fees for insurance products of companies within the scope of Directive (EU) 138/2009 as mentioned in Question 4.

Fee and commission expenses *(Article 8 of the RTS on BI items)* we agree with the mapping proposed and note that the specific item related to outsourcing fees is already included in the official breakdown of fees requested in the template FR_22.1.

Trading /banking book component *(Article 10 and 11 of the RTS on BI items)* For the component "trading and banking book": as the information is not available in the Finrep and accounting framework reporting we will split it on the best efforts basis.

Question 6: What are your views on considering the financial statements used for the final valuation as the only reference for the acquisition of activities under the baseline approach (i.e. full historical data)? Please explain and provide arguments for your answer.

Article 1, point 1, "*Institutions shall include items of merged or acquired entities or activities in their business indicator for the last three financial years based on the audited financial statements of those entities or the financial information used for the final valuation of those activities.*" We consider "**audited**" as external.

Question 7: What are your views on the proposed three alternative calculation approaches instead of a unique alternative approach? Please explain and provide arguments for your answer.

Article 1, point 2, "*If the data referred to in paragraph 1 is not available or accurate, institutions shall adopt, among the below alternative approaches, the one that results in the highest own funds requirements for operational risk: …*". It is **excessively burdensome** for financial institutions to have to consider the application of **three different methods and to apply the most conservative**.

We propose a ranking of these methods and to apply only the first one that is feasible. The order c), a), and b) can be applied for this purpose.

Point 4, "*Institutions shall notify their competent authority when including acquired or merged entities or activities items in accordance with paragraph 2. This notification shall provide evidence of the unavailability or inaccuracy of data referred to in paragraph 1 and present the own funds requirements for operational risk as calculated in accordance with paragraph 2, points (a), (b) and (c).*". **How shall institutions communicate this inclusion?** Based on Article 3, it appears to be an **ex-ante notification.** Is it enough to **send emails** with the data/information required in Article 4?

Question 8: What are your views on not providing any alternative method but merely adjusting the effective perimeter of the disposal? Please explain and provide arguments for your answer.

See Question 7.

Question 9: What are your views on the inclusion of a threshold? Please explain and provide arguments for your answer, as well as, if applicable, further evidence on situations where BI adjustments as set out under Articles 1 and 2 would not be feasible or deemed excessively cumbersome; also identify potential consequences on the dynamics of the European financial markets.

It is worth mentioning that, within a banking group, the capital requirement is calculated at several levels, e.g. group, sub-group, legal entity level. In the definition of a possible threshold, we suggest considering the peculiarities of the calculation level.

In case of a merger among legal entities, it is straightforward to sum up the related financial data of the last three years (legal entity level).

In case of an activity transferred among legal entities: below a certain threshold, there should probably be no requirement to modify past data (legal entity level).

On sub-group level, in the case of legal entities transferred among sub-groups, it is straightforward to modify past data.

On group level, in case of disposal, we do not see any need to define a threshold under which past data does not have to be modified. It will be up to the banking group to decide whether the disposal is significant enough to ask for immediate exclusion of contributions related to disposed parts.

It would be more useful to have a threshold under which the disposed contributions could be excluded without prior notification (or with the submission of ex-post notification only).
For example, if TOTAL OPERATING INCOME, NET (FR 02 r355) of the disposed Company/ TOTAL OPERATING INCOME, NET (FR 02 r355) of the Institution <=2%**,** it should be possible to exclude the related contributions by submitting an ex-post notification (like the criteria applied in EU Regulation 529/2014 for the AMA extensions).
At group level, in the case of M&As, it could be useful to have a threshold below which past data is not modified.

Question 10: What are your views on the basis for the calculation of the threshold? Please explain and provide arguments for your answer.

A simple basis for the threshold can be the total operating income, in order to avoid recalculating all the business indicator items.

In case of M&As, it might be useful to set alternative materiality thresholds (regardless of the level – individual, sub group or consolidated):

- TOTAL OPERATING INCOME, NET (FR 02 r355 c010) of the merged Company/ TOTAL OPERATING INCOME, NET (FR 02 r355) of the Institution <=2%

- operational risk requirement of the acquired company (from the last PILLAR III of the company) / the total of the purchaser operational risk requirement summed up with that of the acquiree>=2%

Question 11: What are your views on the level you consider appropriate for the threshold? Please explain and provide arguments for your answer.

In case of an activity transferred between legal entities or a merger of different legal entities in the group, the modification of past data should not be required at the individual level if the total operating income of the activity transferred or if the merged company is lower than 5% of that of the group. There is no impact at consolidated level.