EUROPEAN ASSOCIATION OF CO-OPERATIVE BANKS
The Co-operative Difference: Sustainability, Proximity, Governance

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EACB comments on

Draft Regulatory Technical Standards
on the components of the Business indicator under Article 314(6)(a) of the CRR and the elements to be excluded from the Business Indicator under Article 314(6)(b) CRR

Draft Implementing Technical Standards
on the mapping of the Business Indicator components with corresponding supervisory reporting references under Article 314(7) CRR

Draft Regulatory Technical Standards
on the adjustments to the Business Indicator under Article 315(3)(a), (b) and (c) CRR

(EBA/CP/2024/05)

General comments

The EACB welcomes the opportunity to comment on this set of EBA draft technical standards on the new requirements for the calculation of the Business Indicator under the new Operational Risk framework.

We appreciate the EBA's efforts to clearly outline the components of the Business Indicator (BI). However, we see that several elements should be better aligned with the level 1 text. We also would like to note that with regard to template OR1, the mapping to supervisory reporting is not provided yet, it would be helpful for institutions to understand whether EBA is planning to establish such correspondence and by when.

Answers to selected questions

Q1: What are your views with regards to the proposal for the ILDC component? Please explain and provide arguments for your answer.

With regard to Art. 3 "Asset component" of the RTS, the EBA proposes that:

"*The asset component shall be calculated as the sum of the following items:*

a) gross carrying amount of cash balance at central banks and other demand deposits […]"

We would like to stress that **the inclusion of cash balance at central banks and other demand deposits in the asset component would not be in line with CRR 3** Art. 314(2), which only includes loans, advances, interest bearing securities, including government bonds, and lease assets in the asset component. Also, FINREP reporting separates loans and advances from cash balances at central banks and other central bank deposits. Point a) of RTS's article 3 should be deleted.

With regard to Art. 4 "Dividend component" of the RTS, the EBA proposes that:

"The dividend component shall include dividend income from equity instruments and investments."

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We note that CRR3 Art. 314 (3) states that dividends from stocks not consolidated in the financial statements of the institution, including dividend income from non-consolidated subsidiaries, associates and joint ventures are not included in the dividend component. **The draft RTS Article 4 should therefore be clarified by adding the same statement of scope included Art. 314(3) CRR 3**.

Finally, we note that there is no reference to Articles 314 (2a) and (2b) of CRR III regarding the possible derogation from Article 314 (2) as in the draft ITS on supervisory reporting for OpRisk (EBA/CP/2024/07).

While Article 314 (2b) is written in the context of ILDC, it reads as if – provided the conditions are met – an institute can apply ASA instead of BIC to calculate its own funds requirements for operational risks in the near future. We see that clarifications should be added (criteria, requirements) on how to apply Article 314 (2b).

Q2: What are your views with regards to the proposal for the Services component? Please explain and provide arguments for your answer.

Articles 5 and 6 should be clarified to cover only items that are not covered by other Business Indicator components but are of similar nature.

Looking at the way the Operating Income is treated under the Service Component, we understand that the recovery of administrative expenses including recovery of payments on behalf of customers (e.g. taxes debited to customers) should not contribute to any of the items requested for the Service Component. It would be helpful if EBA could clarify this explicitly in the text.

We also see that the draft standard lacks clarity with respect to the application of certain elements to institutions that are members of an institutional protection schemes (IPS) on how to implement Article 314 (3) of the CRR III.

Generally, the purpose of an IPS is to protect its members from severe losses that – in the worst case – could lead to the bankruptcy of the concerned institution. Hence, we believe it should be clarified that only "*losses exceeding the risk bearing capabilities of a single member of the institutional protection scheme are subject to mutualization across institutional protection scheme members*".

This circumstance should be acknowledged to avoid unjustified additional own funds being charged to IPS members and to maintain a level playing field with other organizational structures and non-banks.

Q3. What are your views with regards to the proposal for the Financial component? To which extent are you carrying out operations or making accounting choices as referred to under paragraph 2, point a) of Article 9 of this draft RTS? Are you carrying out operations or making accounting choices, other than those specified under paragraph 2, point a) of Article 9 of this draft RTS, that could justify the use of the PBA? Please explain and provide arguments for your answer.

Calculation of the Financial component

The EBA has retained an accounting approach as the approach by default that institutions shall apply to calculate the financial component and considered the prudential boundary approach as a derogation.

Generally, the opportunity to make use of common accounting standards such as IFRS is welcome where members will follow this approach. Overall, a PBA based on an accounting standard (e.g. IFRS trading income) is **a practical solution** as it allows following the accounting standards by performing the suggested adjustments to the AA. Not only is accounting data readily available for institutions, but it is also attested, consistent and transparent and thus builds a functionally valid basis for calculating the FC.

At the same time, we understand the regulators' intention to avoid regulatory arbitrage once a method is chosen and not to leave the choice to one approach or the other. However, **we would like to emphasise that the CRR III has maintained both methods for good reason, since they are appropriate depending on the nature of the transactions**.

Indeed, the CRR3 mandate in Article 314(6)(a) requires the EBA to develop draft regulatory technical standards to specify *"the components of the business indicator, and their use, by developing lists of typical sub-items,* ***taking into account international regulatory standards and, where appropriate, the prudential boundary*** *defined in Part three, Title I, Chapter 3". Moreover,* ***Article 314(4) requires*** *that the trading book component (TC) of the financial component (FC) be defined "****as appropriate either in accordance with accounting standards or, in accordance with Part three, Title I, Chapter 3****, including on trading assets and trading liabilities, from hedge accounting, and from exchange differences".* This wording was the result of discussions between the co-legislators to ensure that approximations that appear when the Business Indicator only relies on the accounting information, can be avoided relying on prudential information. However, it seems that the EBA RTS, as drafted, might go beyond the level 1 requirements, by proposing to make the financial component defined in accordance with accounting standards the default approach and requires a derogation based on several conditions for the use of the prudential boundary approach even though **both the definition of the financial component and the related EBA mandate above require a prudential definition as appropriate.**

Accordingly, where any condition to use the prudential boundary approach is no longer met, a bank would have to reverse to the accounting approach and shall not use the prudential boundary approach in the following three years. **Given the very dynamic nature of trading transactions**, the fact that there is no unwarranted increase in the financial component in a given year should not preclude an institution from using the prudential boundary approach for the following three years where there may indeed be unwarranted increases due to the use of the accounting approach. This requirement appears to be above and beyond the requirements of the text.

Therefore, we suggest that the EBA adheres to the optionality laid down in the Level 1 text and that, according to the fact that the approach used is consistent from one financial year to the next, the EBA clarifies the circumstances under which a passage from one approach to another is permitted.

In addition, an impact in term of RWA between the accounting approach and the prudential boundary approach could only be observed in situation where the TC and the BC are in opposite sign as the global P&L will be the same in both approaches. That could, depending on the activities of the institution, happens only years where large market moves are observed and not every year.

We suggest the followings amendments:

Article 9

"*a) certain types of operations performed, or accounting* ***treatments*** ***~~choices adopted~~****, including the economic hedging of fair value through profit loss positions or the* ***no*** *bifurcation of derivatives embedded in host hybrid or in structured financial instruments,* ***could lead*** ***~~result~~*** *in an unwarranted increase of the financial component when using the accounting approach;"*

Article 13

"c) The description of the types of operations performed or accounting ***treatments*** ***~~choices adopted~~*** *which* ***could*** *cause* ***~~the~~*** ***an*** *unwarranted increase of the financial component and the institution's expectations on their development*"

As by construction, regulatory arbitrage will only happen in crisis situation where (i) the accounting approach is chosen (ii) only one of the prudential banking P&L or prudential trading P&L is negative and (iii) the P&L loss of the negative component is partially or totally offset by the positive component (the other one). The introduction of the article 14 “reversal to the accounting approach” is inappropriate. Indeed, regulatory arbitrage will be the case where an Institution put himself in the incapacity to respect the article 9(2) in time of crisis and revert to the accounting approach.

It will be more appropriate to only include consistency over time on the approach chosen and requiring prior notification to the competent authority before switching from prudential boundary approach to accounting approach.

A revised article 14 would prevent all regulatory arbitrage (based on paragraph that already exist in the CRR):

“Article 14 Reversal to the accounting approach:

> ***An institution shall use, consistently over time, the accounting approach or the prudential boundary approach. An institution shall require prior notification to the competent authority before switching from prudential boundary approach to accounting approach in accordance with the notification process in the article 15.”***

Scope of entities applying the prudential boundary approach (PBA)

According to the draft RTS on the components of the Business Indicator, the prudential boundary approach to be permitted shall apply to all entities of the same consolidation group.

However, for entities with little or no market activities or when accounting portfolios are in line with prudential portfolios, it would be operationally difficult to apply the prudential boundary approach due to the documentation to be provided and due to the policies and procedures constraints compared to the benefits expected, while using FINREP would be easier.

Therefore, we believe that institutions should be allowed to choose the appropriate approach in those specific cases, provided that the approach used is consistent from one financial year to the next and that the approach would change only under specific or rare circumstances.

The proportionality principles should be duly considered, allowing to ensure consistent application avoiding cherry picking at the group level without undue implementation costs. In fact, some entities in the prudential Group may have differences between their accounting and prudential perimeters but with limited unwarranted increase of the financial component. For example, according to art. 325(4), an institution may use a combination of the simplified approach with other approaches at consolidated level to calculate the own funds requirements for market risk. For those entities the cost of implementation largely overseed the benefit. The threshold proposed correspond to simplified standardised approach to calculate the own funds requirements for market risk[1].

[1] 325a ‘Conditions for using the Simplified Standardised Approach’;

An institution may calculate the own funds requirements for market risk by using the simplified standardised approach referred to in Article 325(1), point (c), provided that the size of the institution's on- and off-balance-sheet business subject to market risk is equal to or less than each of the following thresholds, on the basis of an assessment carried out on a monthly basis using data as of the last day of the month:’ ;

(a) 10 % of the institution's total assets;

(b) EUR 500 million.

We suggest the followings amendments to article 9:

[…]

c) all the other institutions included in the same prudential consolidation apply the prudential boundary approach. **By derogation, accounting approach may be retained for institution with no or not significant trading book that do no supersede the lower of the following thresholds:**

- 10 % of the institution's total assets,

- EUR 500 million.

Institutions shall start applying the prudential boundary approach subject to the thresholds set out in this Regulation on the next reporting reference date after those thresholds have been exceeded on two consecutive reporting reference dates. Institutions may stop apply the approach subject to the thresholds set out in this Regulation on the next reporting reference date where they have fallen below the relevant thresholds on three consecutive reporting reference dates.

Notification process

More specifically, we would like to highlight the 90 days timing constraint related to the intention to use the prudential boundary approach that institutions shall notify to the competent authorities before its implementation. We question how supervisors will be able to give prior authorisation to institutions so that institutions can apply the prudential boundary approach to calculate the financial component, when the finalisation of the draft technical standard and submission to the Commission are only scheduled for the end of 2024. Indeed, institutions have 90 days before the implementation date to notify the supervisors of their intention and submit a documented file (P&L monitoring with the prudential boundary, impact of the choice of method, independent audit, etc.). However, based on an implementation date of end-2024, institutions should be submitting their documented files as early as September, even though the technical standard has not yet been published.

Finally, the notification process seems very cumbersome, especially as all the requirements (points (a) to (h) of Article 13.2 of the RTS) should be reviewed annually. All these requirements should only be required for the initial notification of the intention to use the PBA and the annual review should be limited to the independent review on the fulfilment of the conditions to use the PBA (point (h) of Article 13.2 of the RTS).

Q4. What are your views with regards to the proposal for the specification of the items to be excluded from the BI? Please explain and provide arguments for your answer.

According to our understanding, Art. 16 of the consultation paper defines elements that, in contrast to Art. 314 (5) CRR, should be included in the calculation of the BIC. This can, in some cases, lead to considerable implementation efforts on the part of the institution, as the information requested here is usually not readily available. From a practical point of view, this goes hand in hand with the additional effort outlined in the answer to Q2.

Q5. What are your views with regards to the proposed mapping of the BI items to the FINREP cells? Please explain and provide arguments for your answer.

The mapping carried out in this context between the BI components in accordance with Art. 316 (6) CRR III-E and the FINREP templates in accordance with Annex III and IV of the reporting ITS is based on the reporting items of a full FINREP report. However, many institutions report FINREP as data point or simplified approach

users. A review of the mapping has shown that the majority of the reporting items referenced here cannot be reported by data point or simplified approach users on the basis of this mapping. A corresponding mapping should therefore also be provided for these institutions.

Q6. What are your views with regards to consider 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.

NA

Q7. What are your views with regards to the proposed three alternative calculation approaches instead of a unique alternative approach to be defined? Please explain and provide arguments for your answer.

NA

Q8. What are your views with regards to not providing any alternative method but adjustment to the effective perimeter of the disposal? Please explain and provide arguments for your answer.

NA

Q9. What are your views with regards to the inclusion of a threshold? Please explain and provide arguments for your answer, as well, 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 and identify potential consequences on the dynamics of the European financial markets.

NA

Q10. What are your views with regards to the basis for the calculation of the threshold? Please explain and provide arguments for your answer.

NA

Q11. What are your views with regards to the level you consider would be appropriate for the threshold? Please explain and provide arguments for your answer.

NA

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