Comments

EBA/CP/2024/05 Business Indicator

German Lobby Register No R001459
EU Transparency Register No 52646912360-95

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Berlin, May 21, 2024

The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks.

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General Remarks

Facilitations for the first reporting year(s)

The methodology of the new Business Indicator approach and the corresponding reporting template C16.02 (see EBA/CP/2024/07) require the computation of the business indicator and the preparation of the detailed reporting template C16.02 for each of the last three financial year-ends.
We want to highlight that the first reporting dates will be burdensome, as for the first reporting date 31.3.2025 the figures for YE 2024, YE 2023 and YE 2022 must be (manually) processed in retrospect. This is challenging because FINREP reports might not be available in granularity (that is required for the preparation of the reporting form C16.02) or they are not available at all. In cases of deviations from the existing FinRep reporting (notably, concerning adjustments for M&A) the retroactive data provision will be very difficult.

The parallel consultation paper on supervisory reporting (EBA/CP/2024/07) does not make any statements about the first reporting dates using the new approach. The provisions in Annex II, Chapter 4.1.3 of this CP on how to proceed in case of non-availability of historical data, we regard to be only partially applicable for the transition. We therefore believe that facilitations for the phasing-in period (i.e. the first two years) of the new reporting requirements are necessary.
This includes firstly that in line with Annex II (of EBA/CP/2024/07), Chapter 4.1.3, Text 149, breakdowns that cannot be derived from FINREP reports may be determined on a best-effort basis. For example, breakdowns in the trading or banking book may be estimated if not available.
Secondly, a waiver of retroactive adjustments of the FINREP figures for YE 2023 and YE 2022 regarding M&A transactions should be considered. It should be possible to refrain from collecting and preparing data for M&A transactions which took place in the longer past.

Threshold for BI adjustments due to M&A

The draft consultation paper on supervisory reporting under Article 430(7) CRR III concerning operational risks, in particular template C16.02, refers largely to FINREP. However, in case of M&A transactions retrospective adjustments compared to the FinRep figures are required for past years, in which the holdings in the new companies have not yet existed. According to the new RTS (EBA CP 2024/05) to amend the CRR III and the ITS on supervisory reporting, the data of the new companies should generally be integrated into the FINREP figures based on the (audited) financial statements of the respective companies. However, adjusting FINREP figures in this way for past years is very burdensome, especially if there have already been business relationships with the respective companies before the M&A transaction took place. On the other hand, the impact of the adjustments on the business indicator is likely to be of minor impact in most of the M&A transactions and does not justify the efforts for the re-computation of FinRep figures. Therefore, we consider facilitations for M&A transactions with minor impact necessary. For those cases we would appreciate a waiver of the adjustments for M&A transactions. We suggest the threshold to be a relative measure of immateriality such as the M&A factor already introduced by the EBA. For example, up to an M&A factor of 1.1, M&A adjustments could be omitted. Alternatively, a simple basis for the threshold can be the total operating income (e.g. % of Group income/revenue), in order to avoid recalculating all the business indicator items.

Another alternative, which would be a great relief for the institutions, but which would only have minor impact on the business indicator, would be the possibility to use the M&A factor method (according to Art. 1 (2) (b) of the RTS (draft) for adjustments to the business indicator (CP 2024/05)) up to an M&A factor of 1.1 in general (as first resp. standardized approach). In this case up to an M&A factor of 1.1, a notification according to Art. 1 para. 4 of the above - mentioned RTS should be omitted as well as the comparison of the three approaches acc. to Art. 1 par. 2 of the RTS.

Furthermore, we do not consider the inclusion of straightforward acquisitions of equity investments not included in the consolidation scope to be appropriate. Such investments should not be treated as mergers and acquisitions (M&A); clarification is necessary. Inclusion in the consolidation scope could be used as a criterion to classify transactions as M&A.

Timeline for calculations of the BI (particularly adjustments to the BI under Art. 315(3)(a), (b), (c) CRR)

We would like to note that financial statements for the BI N-1 financial year are generally not available by the 31 December deadline, instead the audited statements for the most recent year flowing into the FinRep reporting are only available end of March of the following year (please refer to FinRep reporting schedule for reference). Including them by this deadline, as outlined in para. 32 of the consultative paper, will be challenging or even impossible. We suggest that the data from the last fiscal year should only be used starting from the reporting date of 31 March of the following year. In this matter, we propose to refrain from calculating YE OR RWA from estimated or preliminary YE FinRep to avoid undue volatility of OR RWA during the YE disclosure process.

Institutional Protection Schemes

We would like to point out the need for level-playing field regulation for equivalent business models of institutions. Hence, we would like to emphasize our concerns raised in our answer to question 2 on the equal treatment of institutions that are part of an institutional protection scheme.

Overview of questions for consultation

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

We want to point out that the term "interest earning assets" still encompasses a significant proportion of assets that do not earn interest, mainly consisting of brokerage receivables (largely settlement balances) and non-interest-bearing deposits held with central banks and other financial institutions. Specifically, we propose that for the two pertinent FinRep items (F18_010_005 Cash balances at central banks and other demand deposits, and F18_010_070 Loans and advances @AC), additional clauses ("only those that earn/bear interest") should be added, akin to what is stipulated for derivatives (FinRep F_1.1_10_60). This amendment would ensure that only the portions that generate interest are included.

Why is there no reference to Articles 314 (2a) and (2b) of the CRR III regarding the possible derogation from Article 314 (2) of the CRR III as in EBA/CP/2024/07? Even though 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 would like to see clarification (wrt. criteria, requirements) on how to apply Article 314 (2b).

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

According to our interpretation the function of FinRep lines F45.3_020_040 and F2_010_370/380/390/430, with the additional clause "due to operational risk events and not due to leases," serves to incorporate operational risk (OR) losses into the Service component. We contend that the annual totals from operational risk losses are more accurately sourced from the respective Events recording process rather than directly from the financial statements. Therefore, we recommend providing an option to substitute these FinRep lines with the total loss amount as documented in the OR Events recording database.

The newly introduced Standardised Measurement Approach (SMA) offers a uniform model for banks. However, it may not accurately represent the financial realities of entities that solely generate revenue through "fees from payment services" because it overlooks risk mitigations after the elimination of the Internal Loss Multiplier (ILM). Consequently, this omission renders the capital charge less sensitive to the quality of the internal control environment. Moreover, the lack of risk sensitivity in the Services component, due to the removal of the ILM, impacts entities reliant solely on payment service fees. A better approach for the Services component would involve accounting for fee expenses and deducting them from commission income. Assuming a fixed internal process, irrespective of transaction volume, considering net commission income as a basis for internal controls should logically result in a decrease rather than an increase in operational risk as the process becomes more frequent. Therefore, this method would more accurately mirror the operational realities of such entities because there is typically a correlation between fee expenses and income, similar to how it is factored into the IC component under ILDC.

The proposal lacks clarity with respect to institutions that are members of an institutional protection scheme (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 a worst case scenario – could lead to bankruptcy. Hence, we would propose a clarification 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 by the regulation as otherwise institutions under an IPS wrongfully suffer from being charged additional own funds and a distortion of the level playing field in favor of groups and non-banks would be the consequence.

Additionally, we would like to point out that providing an accounting breakdown related to operational risk events (C16.03 in the context of the SC) is currently not possible. Implementing additional framework for additional separation of an operational risk accounting poses a considerable additional effort to us. Costs of the implementation are disproportionate to the additional benefit from the regulation.

Question 3: 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.

We support the option to use the Prudential Boundary Approach to avoid undue increases in the BI, in accordance with CRR3. In the context of the Financial component and the application of the PBA, we welcome the opportunity to make use of common accounting standards such as IFRS.

Overall, we see a PBA based on an accounting standard (e.g. IFRS trading income) as the most practical solution as it seems inappropriate to deviate from accounting standards by performing the suggested adjustments to the AA. Not only is accounting data readily available for institutes, but also is it attested, consistent and transparent and thus builds a functionally valid basis for calculating the FC.

Question 4: 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 current 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 effort 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 question 2.

Question 5: 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.

Many German institutions report FINREP as data point or simplified approach users. However, the mapping carried out 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. 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, especially in template C 16.02, which requires a high degree of granularity. A corresponding mapping should therefore also be provided for these institutions.

If alternative reporting items are available for non-full FINREP users, these will be used. If this alternative is not available, the reporting item is not filled. This could lead to a tendency to use higher values in the reporting items, as total positions are also reported, among other things.

If reporting items are named in the FINREP reporting items that are not relevant for HGB users (see completion instructions for FINREP), the reporting item cannot be completed in the OpRisk reporting form.

Concerning the Asset component (see. Article 3 of the RTS on BI items, p. 34): The described “total assets” comprise gross carrying amount positions and carrying amount positions. However, total assets are defined as carrying amount. To deliver reliable data, all required positions which relate to template F18.00 should include column 0130 “accumulated impairment”.

“Cash balances at central banks and other demand deposits” (the position asset component (a)) does not contain “cash on hands” (ref. F01.01. Cash, cash balances at central banks and other demand deposits).

We propose to provide a clearer correspondence between the items included in the calculation of the business indicator as listed in the regulatory technical standards mandated in accordance with Article 314(6) and the according positions of the FINREP templates laid down in in Annexes III and IV of Commission Implementing Regulation (EU) 2021/451 to narrow down the scope of interpretation and therefore achieve better harmonization level across all institutions.

Double counting: Interest income “(k) profits from leased assets including gains from lease modifications” F45.03_r0040_c0010 (only from leased assets) versus other operating income “(b) income from other income” F45.03_r0040_c0010 (in total).

Question 6: 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

Question 7: 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.

Requiring financial institutions to apply among three different methods the most conservative constitutes some additional effort. In this matter we would like to highlight the possibility to use the M&A factor method in a general way (e.g. as first resp. standardized approach), for example up to an M&A factor of 1.1. This would only have minor impact on the business indicator but can constitute a great relief for the institutions. In that case we also propose that for an M&A factor up to 1.1, it should not be necessary to issue a notification according to Article 1, paragraph 4 of the referenced RTS.

Question 8: 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.

Please refer to Q7.

Question 9: 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.

We support the Inclusion of a threshold to have a de minimis criterion for focusing on the M&A that create a substantial impact on the BI. Adjusting FINREP figures for past years is very burdensome in cases where there have already been business relationships with the respective companies before the M&A transaction took place. Yet these kinds of activities would have very limited impact in the end. It should also be noted that any such M&A, even if it is below the threshold, is already reflected in the next YE Business Indicator / RWA calculation following the M&A, resulting in full recognition only very few quarters after the M&A, so the focus should only be on material intra year impacts. This, in our view, questions the effort for re-computations of FinRep figures.

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

We suggest a threshold to be a relative measure, below which past data are not modified, and to be aligned with other out of cycle adjustments to financial statements (e.g. late adjustments to YE financials). As reasonable measure of immateriality could also serve the M&A factor already introduced by the EBA (i.e. M&A adjustment omitted up to a M&A Factor of 1.1). A simple basis for the threshold could also be % of Group income/revenue.

Question 11: 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.

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