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Association for Financial Markets in Europe

## Consultation Response

# Consultation on Implementing Technical Standards on supervisory reporting concerning operational risk (EBA/CP/2024/07)

April 2024

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the EBA's **Consultation on Implementing Technical Standards on supervisory reporting concerning operational risk (EBA/CP/2024/07)**. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

We summarise below our over-arching comments in relation to the consultation, which is followed by answers to the individual questions raised.

**Comments and observations:**

The consultation paper does not make any statements about the first reporting dates using the new approach. The methodology of the new Business Indicator approach and the corresponding reporting template C16.02 as well 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. To our understanding this means, that for the first reporting date 31.3.2025 the figures for the reporting dates YE 2024, YE 2023 and YE 2022 must be retrospectively processed. Even if FINREP reports are available for these reporting dates, the reporting data is not available in the granularity required for the preparation of the reporting form C16.02. In all cases of deviations from the existing FINREP reporting (adjustments for M&A, need for more granularity) the retroactive data provision is very burdensome.

The provisions in Annex II, Chapter 4.1.3, on how to proceed in case of the non-availability of historical data, seem to be only partially applicable for the transition to the new approach. We consider it necessary to include facilitations for the period of phasing-in of the new reporting requirements, i.e. the first two years after the entry into force of CRR III:

1. A waiver of retroactive adjustments of the FINREP figures for YE 2023 and YE 2022 with regard to M&A transactions should be granted. It should be possible to refrain from collecting and preparing data for M&A transactions which took place in the longer past.
2. In accordance with Annex II, Chapter 4.1.3, Text 149, breakdowns that cannot be derived from FINREP reports may be determined on a best-effort basis, e.g. breakdowns in the trading or banking book may be estimated if not available.

In addition, respondents see critical aspects mainly related to:

- The reference dates used for reporting quarterly BI calculation on template C 16.02.

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Respondents raise difficulties and inconsistencies with the CRR in the proposed framework for the reporting of the full set of information on the Business Indicator as of 31/12/N at the Q4 remittance date. The draft RTS and ITS require the calculation and reporting information based on audited financial figures. However, it will be not feasible to use the 31/12/N data, as these audited financial figures are not available when producing and publishing the Q4 Corep.

In this sense, respondents strongly ask to report data as of 31/12/N-1 for all remittances of the year (i.e., from Q1 to Q4). This would allow institutions and supervisors to have consistent audited figures over the same calendar year.

- The framework for the use of the Prudential Boundary Approach (PBA) on template C 16.02.

According to Article 314.4 of the CRR, the trading book component (TC) of the financial component (FC) should be "defined as appropriate either in accordance with accounting standards or, in accordance with Part three, Title I, Chapter 3" (i.e., the prudential boundary criteria). This requirement is also explicit in the mandate of Article 314.6 which requires that EBA develops the list of typical sub-items of the business indicator by "taking into account international regulatory standards and, where appropriate, the prudential boundary defined in Part three, Title I, Chapter 3".

The draft RTS on the new framework for the business indicator for operational risk, also under consultation, does indeed provide the two required approaches to calculate the financial component in the proposed accounting approach (AA) and prudential boundary approach (PBA). There are, however, several issues with the requirements envisaged by EBA.

First and foremost, the AA has been made the default approach while the PBA can only be used by way of derogation after meeting some conditions. This requirement goes beyond that of the CRR which does not favour one approach over another but, rather, requires that the PBA be available where and as appropriate. An institution should therefore be able to choose the PBA on a permanent basis if it considers such approach as appropriate. It should be noted that the CRR already imposes very strict requirements for the management of the trading book including for the inclusion of positions (Articles 102, 103 and 104), and equally strict rules to reclassify a trading book position (Article 104a) which contributes to the robustness of the PBA approach. However, to avoid continuous changes from one approach to another, it appears reasonable that when an institution has made the decision to apply the PBA, it would only be permitted to revert to the AA (and the other way round) if such change if triggered by material evolutions of its activity, environment or risk management (for example a change of business model) and after approval from the competent authority. This would provide the consistency required for having a sound framework for the PBA and would ensure that no regulatory arbitrage is possible which, as previously mentioned, is already prevented by trading book framework of the CRR.

Second, in the approach proposed in the RTS on the new framework for the business indicator for operational risk the application of the PBA is conditional on several criteria including the presence of certain operations or accounting choices that result in an "unwarranted increase" of the FC when using the AA. Once again, this would limit the usage of PBA while CRR does not favour one approach over another nor intent to limit the usage of PBA. Furthermore, an unwarranted increase in the TC's P&L can be volatile by definition as it can be impacted by several market factors. An institution can therefore experience an unwarranted increase in a given reporting period and not experience any in a following reporting period while having similar operations and accounting choices. The application of the PBA should, therefore, not be based on an unwarranted P&L increase in the TC nor be subject to any limitation.

Finally, the notification process seems very cumbersome, especially as all the requirements (points (a) to (h) of Article 13.2) 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).

Additional general comments on track changes Final draft ITS

The respondents noticed that when final versions of ITSs are published on the EBA's website the track changes versions of the templates (Excel) and instructions (Word) provided are the ones between the former ITSs and the amended ITSs.
No track changes versions of templates / instructions are provided between draft ITSs consultation and final draft ITSs.

In this sense, to ease the comparison between the consultation versions and the final amended versions, could the EBA:

1. Continue to provide the track changes versions of templates/disclosures between the current ITSs in application and the amended ITSs to be applied? (as is currently the case)
2. Also provide the track changes versions of templates and instructions between draft ITSs submit to consultation and final draft ITSs.

***Question 1: Are the instructions and templates clear to the respondents?***

1. **Asset component (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. In order to deliver reliable data, all required positions which relate to template F18.00 should include column 0130 "accumulated impairment".

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

2. **Established 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) of Regulation (EU) No 575/2013 (hereinafter "RTS on BI items") and the cells of the FINREP templates laid down in Annexes III and IV of Commission Implementing Regulation (EU) 2021/451. (p. 33-38)**

   - We propose to provide a clearer correspondence between the items included in the calculation of the business indicator and the according positions of the FINREP templates 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 2:*** *Do the respondents identify any discrepancies between these templates and instructions and the calculation of the requirements set out in the underlying regulation?*

**Template 16.02 (OPR BIC)**

Exchange rate. The calculations of operational risk requirements are based on the average of the values of the last three financial years. Taking also into account that operational risk losses will materialise in the currency in which the company operates, we consider that the exchange rates to be applied in the case of subsidiaries with a currency other than the € for the purposes of calculating own funds requirements for operational risk should be the exchange rate at each reporting date.

Otherwise, should FINREP exchange rates were used, capital requirements should be:

- Outdated: Up to a 3-year gap since historic FX rates would be used.
- Inconsistent with credit & market risk frameworks, which are calculated with up-to-date FX rates.

## Use of clean price approach and TB/BB reclassification – template C 16.02

Regarding the determination of the ILDC component and the Financial Component, it appears that institutions using the so called "clean price" to produce the Finrep reporting might be penalized compared to institutions using the "dirty price" approach.

As a reminder the clean and dirty price approaches are detailed in Instructions for Finrep reporting (Annex 5) as detailed bellow:

"*Interest income and interest expense from financial instruments measured at fair value through profit or loss and from hedging derivatives classified in the category 'hedge accounting' shall be reported either separately from other gains and losses under items interest income' and 'interest expense' ('clean price') or as part of gains or losses from these categories of instruments ('dirty price') (...)*

*'Interest income. Financial assets held for trading' and 'Interest expenses. Financial liabilities held for trading' shall include, where the clean price is used, the amounts related to those derivatives classified in the category 'held for trading' which are hedging instruments from an economic but not accounting point of view to present correct interest income and expenses from the financial instruments that are hedged (...)*

*Dividend income on equity instruments measured at fair value through profit or loss shall be reported either as 'dividend income' separately from other gains and losses from those classes of instruments where the clean price is used, or as part of gains or losses from those classes of instruments where the dirty price is used".*

Institutions using the clean price approach reclassify interest income & expenses and dividend incomes from gains and losses from instruments held for trading or instruments designated at fair value through profit or loss to interest incomes & expenses and dividend income within F02.00. This does not constitute an accounting choice or method. These reclassifications are made for Finrep reporting purpose only.

However, in a situation where the P&L of the trading book of an institution would be negative, this reclassification would result to: i) deepen the loss of the P&L of the banking book and ii) increase the amounts of dividend incomes (as for example dividend revenues stemming from equity instruments measured at FV would be reclassified in dividend income).

That will mean that an institution using clean price approach for Finrep would be penalized compared to an institution using the dirty price approach as, considering the same P&L profile, in case of negative P&L of the trading book, one institution using clean price would see its FC (based on absolute value) increased by the amounts related to dividend revenues or net interest and its ILDC increased by the same amount, where another one using dirty price would not suffer from this effect.

We consider that institutions using clean price approach should not be penalized by the application of the clean or dirty price approach and ask EBA to allow institutions to neutralize the negative impact of the reclassification made for Finrep purposes (with the same reclassification mechanism that the one used for AA to PBA approach but allowing reclassification of dividend revenue and interest incomes/expenses from ILDC to FC).

**Template 16.03 (OPR BD)**

We would like to refer to Template 16.03 – Operational Risk Breakdown (OPR BD), where institutions are requested to report the following information: losses, expenses, provisions and other financial impacts resulting from operational risk events.

We would like to highlight that there seems to be a discrepancy between Article 314.5 of CRR3, which lists the elements that should be excluded from the calculation of the Business Indicator, and some of the items being requested in Template 16.03.

So, while Article 314.5 states that "institutions shall not use any of the following elements in the calculation of their Business Indicator":

(a) "Administrative expenses, including staff expenses, oursourcing fees paid for the supply of non-financial services, and other administrative expenses"
(f) "depreciation of tangible assets and amortisation of intangible assets, except the depreciation related to operating lease assets, which shall be included in financial and operating lease expenses";

… the Template 16.03 is not consistent with this Article and requests the following fields:

- 0020 "Administrative expenses to operational risk events"
- 0030 "Depreciation due to operational risk events"

It would be necessary to amend fields of Template 16.03, by:

- Removing 0020 to comply with the exclusion of Administrative expenses
- Amending the content of 0030 so that it corresponds to "Depreciation related to operating lease assets".

***Question 4 - Cost of compliance with the reporting requirements**: Is or are there any element(s) of this proposal for new and amended reporting requirements that you expect to trigger a particularly high, or in your view disproportionate, effort or cost of compliance? If yes, please:*

- *specify which element(s) of the proposal trigger(s) that particularly high cost of compliance,*
- *explain the nature/source of the cost (i.e. explain what makes it costly to comply with this particular element of the proposal) and specify whether the cost arises as part of the implementation, or as part of the on-going compliance with the reporting requirements,*
- *offer suggestions on alternative ways to achieve the same/a similar result with lower cost of compliance for you.*

1. **Adjustments due to mergers & acquisitions**

   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.

   To determine how the adjustments should be made, a new RTS (EBA CP 2024/05) to amend the CRR III and the ITS on supervisory reporting will be published. In general, the data of the new companies should be integrated into the FINREP figures based on the (audited) financial statements of the respective companies.

   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. Against this background, we consider facilitations for M&A transactions with minor impact necessary.

   We would appreciate a waiver of the adjustments for M&A transactions as long as those transactions are of minor significance. A reasonable measure of immateriality could be 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. 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). 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.

2. We propose to exclude row 0310 in template 16.02 (OPR BIC), exclude the reference in the disclosure template and to exclude the template 16.03 (OPR BD) (consultation paper point 59 – we prefer option 1b: not to add a template with a breakdown of the total losses, expenses, provisions and other financial impacts).

   Currently, most banks are not able to get this information directly via the General Ledger. Such implementations are connected with high costs due to new releases. These detailed information are not

relevant for calculating the BIC as they already are part of the item “other operating expenses”, therefore it is not necessary to collect all the details.

3. We propose to exclude the rows 0420-0440 and 0470-0510 from the template 16.02 (OPR BIC).

   Currently, some are not able to get this information directly via their General Ledger. Such implementations are connected with high costs due to new releases. This detailed information is not relevant for calculating the BIC as they are part of the Trading and Banking book component. Therefore it is not necessary to collect all the details.

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