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EFBS position paper regarding the revisions to the simpler approaches for operational risk

The European Federation of Building Societies (EFBS) welcomes the initiative of the Basel Committee on Banking Supervision to consult the relevant credit institutions in the process of revision of the simpler approaches (the Basic Indicator Approach (BIA) and the Standardised Approach (TSA)) for the calculation of the capital requirements for operational risks.

The EFBS is an association of credit institutions and organisations that assist in and support the financing of home ownership. Its purpose is to encourage the idea of acquiring home ownership in a Europe that is converging, both politically and economically. Bausparkassen grant loans secured by residential property to finance home ownership as a bulk business. In addition to this, Bausparkassen business in the stricter sense, Bausparkassen are also allowed to make investments, however only in particularly safe investment vehicles. In times of crisis, Bausparkassen as specialized credit institutions have proved to be particularly resistant. Their low risk business model is determined by the strict legal provisions for the Bauspar business and for the reduced possibilities of financial investment.

The EFBS would like to comment on several elements of the revised Standardised Approach (Section III) in the following manner:

1. Replacement of Gross Income with the Business Indicator; services component

The revised Standardised Approach is based upon the Business Indicator with its three components (the interest component, the services component and the financial component). The services component is the sum of the Fee Income, Fee Expense, Other Operating Income and Other Operating Expense. The services component is of substantial importance to the Bausparkassen. The Basel Committee has identified the disproportionately large impact of the revised Standardised Approach on the capital requirements of specialized institutions, which hold due to their business model an important services component (no. 46 of the consultation paper). According to the Committee the disproportionate impact on these specialized institutions results from the way the Business Indicator is tailored for the operational risk profile of a universal bank and *"does not lend itself to accurate application in the case of banks engaged predominantly in fee-based activities"*.

Based on our estimation, we are therefore expecting considerably higher capital requirements to be imposed on Bausparkassen. In addition, the Basel Committee also considers in its proposal a further premise which does not apply to the business model of Bausparkassen.

It provides in number 20 that *"Unlike in the case of lending business, where funding and investing are closely tied to each other, there is no comparable relationship between services offered and services used. Here, the sum of fee income and expenses better captures a bank's operational risk in services activities, while netting would result in an underestimation of the scale of operations"*.

In the case of Bausparkassen, the Fee Incomes resulting from the acquisition fee paid for the conclusion of a Bauspar agreement as well as Fee Expenses linked to the pay-out of the acquisition

fees are directly interdependent. The expenses only accrue when incomes are generated and otherwise completely fail to appear.

For cases where Fee Incomes and Fee Expenses completely condition each other, EFBS advocates the possibility of a netting of these positions. In contrast, an addition of the Fee Income and Fee expenses would lead to a significant overestimation of the operational risk.

Particularly specialized banks, such as Bausparkassen, with a focus on the fee-based distribution, would be strongly disadvantaged by an addition of the Fee Expenses and Fee Incomes in the services component. The part of the capital requirement which is not justified in the view of EFBS, increases thereby even more, the smaller the Fee marge is.

For Bausparkassen a further distortion arises from the suggested calculation of the services component. If for instance, a financial product is distributed by a freelance collaborator in the field service on the basis of fees, these fees are taken into account in their entirety as Fee Expenses in the services component. However, if employed staff distributes services on the basis of a fixed salary component, this expense is not considered by the Business Indicator. This inconsistent assessment of cash flows only derives from the distribution channel; although diverging potential risks cannot be identified.

Therefore, EFBS urges the Basel Committee to consider adequately the business model of Bausparkassen.

2. Improving calibration of the regulatory coefficients; a layered approach

According to the layered approach the coefficient increases with the size class of the Business indicator. The progressive approach can entail an overestimation in the assessment of the operational risk. With a group of institutions this becomes clear when there is a higher capital need for operational risk on group level than it would result from the sum of the capital needs of the institutions of the group on individual level.

In the opinion of the EFBS, it cannot be in the intention of the Basel Committee to introduce a higher burden on group level. Therefore, the capital needs for operational risk should be limited on group level to the sum of capital needs of the institutions of this group on individual level.