

To: Secretariat of the Basel Committee on Banking
Supervision

Bank for International Settlements

CH-4002 Basel Switzerland

Kraainem, 3 June 2016

Réf: EUF/16-06

Re: Response to the Consultative Document on Standardized Measurement Approach for operational risk

To whom it may concern:

We are writing in response to your request for feedback on your consultative document on the proposed changes to the simpler approaches for measuring operational risk capital. The European Union Federation (EUF) is the industry body and voice for the European factoring industry. The EUF's members consist of 14 national factoring and commercial finance associations (representing 15 EU-member states, namely [in alphabetic order] Austria, Belgium, the Czech Republic, Denmark, France, Germany, Greece, Ireland, Italy, the Netherlands, Poland, Portugal, Spain, Sweden and the UK) and the international factoring chain FCI+IFG. In 2015, the Receivables Finance industry in the EU provided over €168 billion of working capital financing to over 171,000 businesses, mostly SMEs. This amount of working capital has to be seen in relation to the total factoring turnover, which in 2015 was over € 1.47 trillion. If you consider that the total GDP of Europe exceeded € 13 Trillion, this figure represents a significant portion of the real economy within the EU. Our members account for 97% of the total European factoring market, and comprise of both regulated and non-regulated factoring companies. Over half of the factored volume conducted within the EU is generated by factoring companies that are banks or part of consolidated banking groups, which fall under the umbrella of regulatory oversight.

As you may know, factoring is a means of finance which is widely used, especially by SMEs, as a method of providing working capital finance to a supplier of goods and services. This is achieved by the supplier assigning and selling its accounts receivable to a factoring company. The factor will provide a range of services to its clients, including providing working capital against the assignment of their receivables, accepting the risk of bad debts and collecting on past due accounts. The factor will usually charge an administration fee for these services and a discount charge for the advancement of funds against eligible assigned invoices. Factoring has been accepted as a stable financing alternative by many companies, particularly during the financial crisis over the last five years. Many SMEs that were unable to obtain traditional bank funding were able to obtain funding under factoring facilities, offered by bank owned and independent factoring companies. Hence, the factoring industry thrived during the financial crisis, helping hundreds of thousands of SMEs throughout the EU to obtain working capital. You could say that factoring companies are a direct mirror of the real economy.

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The EUF, in its role of representative of specialized factoring companies, would like to underline that it is not convinced by the "one size fits for all" approach that the Committee proposes to introduce and would like to emphasise, in particular, the impact of the new proposal under:

- i) the business perspective, and
- ii) the organizational perspective.

On the "business" profile, the EUF would like to underline that factoring, included in the "Commercial banking" business line under the current approach, is a kind of business that is not exposed to significant operational losses: available figures suggest that factoring companies are in the main only exposed to losses arising from external fraud, losses arising from an unintentional or negligent failure to meet a professional obligation by specific clients and losses from failed transaction processing or process management.

Moreover, academic studies have demonstrated that some business lines are less risky, from an operational perspective, than others: in particular, Moscadelli¹ pointed out that "*Concerning the outcomes of the analysis, there is **clear evidence** of the considerable magnitude of operational risk in the businesses carried out by the 2002 LDCE banks as well as **of the differences in the riskiness of the BLs** (in terms of both the time-unconditional severity and the 1-year aggregated capital figure). These differences persist after comparing, for a typical international active bank, the BLs capital figures with the average Gross Incomes and obtaining ratios as the coefficients set in the revised framework of the Capital Accord. In practice, the bottom-up analysis of the 2002 LDCE data suggests that **the actual operational riskiness of the BLs may be captured in a more effectively way by setting, for the regulatory coefficients of the Standardised Approach, a wider range than the current one**; besides, for the eight BLs as a whole, the implied capital ratio results to be a slightly lower figure than the coefficient envisaged in the Basic Approach.*"

The SMA, as expressed in the consultative document, does not recognize the evidence or smooth the different operational riskiness of the business lines though the application to the Business Indicator (BI) of a coefficient diversified only by size and not by business line. This smoothing appears to be even more evident for smaller institutions, as long as for those included in Bucket 1 (i.e. BI lower than €1bn) where the Loss Component does not apply. Under the SMA, small institutions specializing in factoring will be subject to the same capital requirement for operational risk, ceteris paribus, of a much more risky bank (e.g active in investment banking or trading intensive business models), as it will not benefit from its experience of lower operational losses.

The EUF believes this is a counterintuitive and unwanted consequence of the SMA and therefore suggests to calibrate the BI Component differently according to the non homogeneous risk of each business line and not only to the size of the institution.

¹ Marco Moscadelli, "The modelling of operational risk: experience with the analysis of the data collected by the Basel Committee", Banca d'Italia, Temi di discussione Number 517 - July 2004.

Regarding the Loss Component, whilst maintaining the above-mentioned need for a differentiated calibration for business line, we agree with the (unexpressed) view of the Committee that implementing a fully compliant loss database could be an unnecessary burden for the smallest institution, so that the application of the Loss Component also to Bucket 1 could result as not resolving the problem. We also advise for a more important role of the Loss Component, for the relevant buckets, in order to benefit the more virtuous institutions.

From the "organizational" perspective, the above-mentioned disadvantage for the institutions specializing in certain businesses, like e.g. factoring, intensifies for companies and banks that are organized as a group. The way the SMA framework is applied within a group should be clarified, as individual and consolidated requirements could be inconsistent.

At consolidated level, SMA calculations use fully consolidated BI figures (net all the intragroup income and expenses), while at subconsolidated level it is suggested the use of BI figures at that particular sublevel, even at subsidiary level. We underline that this calculation could lead to inconsistent results: the BI component at legal entity level could well be in a different bucket of BI than the consolidated one, thus applying a different and lower coefficient. In this situation, the sum of the consolidated requirement will obviously be higher than individual requirements due to the increasing level of the coefficient. The capital gap between consolidated and subconsolidated level is further magnified as Bucket 1 does not apply the Loss Component. Hence, we notice that this approach is more punitive for small institutions which are part of a group than for individual ones and causes biased competition within specific markets, such as factoring.

According to the analysis made by the Committee, "operational loss exposure increases more than proportionally with the BI". The EUF therefore suggests that small, specialized institutions should benefit from their lower and simpler structure and that such benefit should be maintained also at consolidated level, as those companies should be in the position to have a better control of their operational losses than others. In order to achieve this result, the SMA calculation should follow a "bottom up" approach instead of a "top down" approach, so that the total requirement will be the sum of the individual requirements.

Finally, EUF would like to add two comments :

- Basel rules apply to all credit institutions in Europe and not only to big international banks. Consequently, it is justified to provide better calibrations on a solo but also on a consolidated basis for low risk activities such as factoring ;
- as BCBS said that the final regime – of which the revision of the operational risk framework is a part – should not generate supplementary capital requirements, there should be no supplementary capital requirements in respect of the revision of operational risk framework.

Thank you in advance for your attention. We look forward to hearing back from you. In the meantime, if you have any questions or want additional information and details about the above mentioned position of the EUF, please do not hesitate to contact Diego Tavecchia, Chairman of the Prudential Risk Committee of the EUF (contact details below).

With kind regards,



Erik Timmermans
Chairman EUF

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