**Swedish Fintech Association response to the EBA public consultation on 'Technical standards on the new Business Indicator framework for operational risk' (EBA/CP/2024/05)**

The Swedish Fintech Association ('SFA') welcomes the opportunity to respond to EBA's consultation on technical standards on the new Business Indicator framework for operational risk.

**About Swedish FinTech Association:**
Swedish FinTech Association gathers around 90 companies within the Swedish fintech sector with the purpose of creating an innovative and competitive fintech market.

While the proposal brings much needed clarification to the business indicator components, SFA is of the view that the current proposed calculation promotes traditional interest-driven business models and puts new innovative business models that are more fee and commission income driven at a disadvantage. It is important that the EBA protects the level playing field and free competition by making sure that the business indicator component of the calculation does not lead to double counting of the assets. In our response we will therefore focus on responding to questions 1, 2 and 5 from the consultation.

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

The model to calculate capital requirements for operational risk should be neutral in terms of business models and ensure that the calculations do not favour certain business models over others. SFA is concerned that new and innovative business models are disfavoured in the operational risk calculations and detracts from the dynamism of the European economy.

The main characteristics of the interest, leases and dividends component ('ILDC') are clearly stated and relevant and SFA welcomes the use of a minimum function between Net interest and interest bearing assets. However, due to the inconsistent use of minimum function for ILDC and maximum function for the Services Component ('SC'), in combination with an accounting based approach, there is a risk of double counting the risk for non-interest assets which generate fee income.

Strictly using an accounting based approach leads logically to the inclusion of all loans and advances on the balance sheet in the Asset Component. This is not consistent with the purpose of recital (3) of the proposed RTS which states that the asset component should include "*all assets that generate interest income or interest expenses*".

Many modern banks such as neo banks or free current account banks have business models that rely on fee income on short term loans. These loans are not seen as generating interest in accounting terms, and the income from these loans are accounted for as fee income. However, the loans will be reported as loans and advances (according to FINREP terms) on the balance sheet. Depending on the size of the different components, the inconsistent application of a minimum function in the ILDC and a maximum function of the SC, there is a high risk of double counting capital requirements for the same loans. This as the loans could be included in the Asset component in the ILDC, while the fees generated from the loans are also included in the SC.

We therefore ask the EBA to instead consider the full yield of the assets and include all income related to the assets in the IDLC, whether from interest or fees. At minimum, we ask the EBA to exclude non-interest bearing assets from the asset component.

$$ILDC = \min(IC, 0.0225 * AC) + DC$$

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

The calculation method for the SC overstates the risks of specific banking activities compared to the ILDC component. The method is disproportionately disadvantageous for institutions with a non-traditional or fee-heavy business model, something that already has been pointed out by the Basel Committee on Banking Supervision (see article 46 of the Consultative Document Operational Risk Revisions to the simpler approaches published October 2014).

The purpose of developing the method according to the preambles is to capture the operational risk profile for a universal bank. The number of institutions engaging in fee-based activity has increased in recent years, especially in terms of short-term credit. The risk profile for these types of exposures is identical or similar to longer-term retail exposures with an interest-based payment structure.

Furthermore, business models with low margins where net commission income is driven by volumes or transactions, will be further penalized by the use of the maximum function, compared to business models with fewer transactions with higher margins, which is not motivated by a higher operational risk. This has been recognised by the BCBS in previous consultations.

SFA therefore believes that the capital charge for operational risk should preserve a level playing field and be neutral in terms of business models. For example, a bank which provides short term credit to a consumer in connection with an online purchase will receive a fee, typically from the retailer and set as a % of the purchase (=loan) amount. However, the bank will also incur fees directly in connection with the transaction, such as settlement or interchange fees for settling payment with the retailer. We ask the EBA that the calculation method for fees and commissions should be equivalent to the interest calculation in ILDC, meaning that the net of commission income and commission expenses incurred in generating commission income should be considered instead of the gross amount.

Also, the EBA should consider the Basel Committee's alternative calculation of the SC for high fee banks, as proposed in article 21 of the *"BCBS's Consultative Document on Standardised Measurement Approach for operational risk (March 2016)"*. The EBA should take note that a considerable period of time has passed since work was undertaken at the Basel level on this topic and the banking landscape has developed, with the new fee-based business models now comprising an ever-growing share of EU banking activities. We therefore believe that the current calculation of the SC may lead banks to abandon certain business lines, making the business models of the institutions less diverse. Alternatively, the institutions may push down the additional costs of the business lines on the customers themselves.

Furthermore, similar to the comment to the ILDC, there is a risk of double counting the capital requirements for the same assets in both SC and ILDC for companies lending for fees instead of interest. The SC component should ensure no double counting, i.e. fees driven by loans included in the asset component should be excluded from the service component.

*SC formula:*

$$SC = \max(OI, OE) + \max(FI, FE)$$

*BCBS's alternative SC formula:*

21. The Services component of the BI for high fee banks is presented below:

$$\begin{aligned} \textit{Services Component} &= Max[\textit{Other operating income}, \textit{Other operating expenses}] \\ &+ Max[|\textit{Fee Income} - \textit{Fee Expenses}|, Min\{Max(\textit{Fee Income}, \textit{Fee Expense}), 0.5 \\ &\cdot \textit{unadjusted BI} + 0.1 \cdot (Max(\textit{Fee Income}, \textit{Fee Expense}) - 0.5 * \textit{unadjusted BI})\}] \end{aligned}$$

**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.**

Strictly adhering to the FINREP mapping does not appropriately consider the risk and risk profile of the institution. Two products with similar risk profiles will be treated separately depending on if there is a fee payment or a series of interest payments connected to it. This is not only punitive for high fee companies, there is also a risk of double counting the capital requirements for the same assets in both the ILDC and the SC. As argued under question 1 and 3, the mapping of the fees directly connected to Loans & Advances included in the asset component should be mapped towards the ILDC, taking into account the full yield of the assets. Alternatively, those assets, for which there is no interest, and the fees are included in the SC, should be excluded from the asset component.

We therefore ask the EBA that the mapping instead should have a basis in the risk profile of the product connected to the Profit and Loss account.

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