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Basel Committee on Banking Supervision

Consultative Document on Standardized Measurement Approach for Operational Risk

Italian Credito Cooperativo position paper

Federkasse, the Italian Federation of Co-operative Credit Banks, represents the interests of 360 Credit Co-operative Banks (BCCs). Although being the smallest banks in the Italian banking sector, they are relevant players in the SMEs and households lending market. They operate according to a safe and simple business model.

Federkasse welcomes the opportunity to comment on this consultative document in which the Basel Committee puts forward policy proposals to replace the current approaches for operational risk.

We agree with the Basel Committee that a consistent application of comparable standards by global banks will benefit stability and public confidence. On the other hand, we believe that reaching this goal should do no harm to small banks featured by simple business models for which simplicity is of paramount importance. Indeed, for this type of banks, the costs and the administrative burden necessary to set up a proper historical internal loss database often exceed the benefit of a more risk sensitive capital requirement. The opportunity to continue using a simplified method would therefore be appreciated. Since European regulators usually extend to non-internationally active banks BCBS standards it is important that this new set of rules will maintain the possibility to use a simplified and not penalizing option.

In order to convey Federkasse's assessment of the proposal we would like to start with the impact assessment of the measures proposed, carried out on a sample of 346 banks members of his network (see annex 1 for the main characteristics of Italian Credit Cooperative Banks):

1. All 346 banks included in the sample showed a Business Indicator less than EUR 1 billion and therefore they would potentially be included in the Bucket 1. The calculation carried out according to the methodology illustrated in the BCBS consultative document showed that the application of the SMA would lead to a small reduction of the capital requirement for the full sample (approximately 7%). However, the capital requirements would increase for 16.5% of the banks; the increase would be, on average, about 15% for each bank;
2. From a second simulation exercise, in which the sample of banks has been considered as a consolidated group, the calculated Business Indicator would fall within the Bucket 3. Assuming an Internal Loss Multiplier equals 1, the capital requirement would be 39.9%

higher than those required by the current methodology and more than 50% compared to the sum of the capital requirement of individual banks based on the new methodology. According to further simulations carried out on this sample of banks the application of the SMA would not bring about an increase in capital requirement only for levels of Loss Component / BIC less than 0.2.

Therefore, from the point of view of the single Credit Cooperative Bank (BCC) the proposed SMA indicator appears fair: it is simple and does not increase the capital requirement; the main problem with the SMA indicator stems from the large increase in capital requirement occurring if the same banks are part of a group; this is the case of Italian Credit Cooperative Banks. According to a recent law approved by the Italian Parliament, BCCs will be part of a consolidated group in two years time. Therefore the burden imposed on the banks joining this group appears not only particularly heavy but also completely unjustified because:

- A consolidated group formed of a large number of small banks, all falling into bucket 1, would not have the possibility to calculate the loss component, as the latter is not envisaged for the calculation at the individual level; the estimated increase of more than 50% of the capital requirement, passing from the sum of the individual requirements to the group level, appears then inevitable; in addition, this increase is not justified by the overall size of the group, because the risk of operational losses by such a group is simply the sum of those registered at the individual bank level; all banks are of small size, working within their local area, without interconnection among them; therefore the operational risks does not appear to be correlated;
- Extending the use of internal loss multiplier also to the bucket 1 banks would not be an appropriate response to this problem; in fact, building up a data collection procedure in line with the proposed BCBS criteria would put a very heavy burden (in terms of administrative and organizational costs) on very small banks with simple business model and would create an uneven playing field comparing with other banking groups made up of large banks (whose dimension would justify a data loss collection) and small standalone banks (which would calculate operational risk capital according to the bucket 1).

For those reasons, we argue that, for groups formed by a large number of banks all falling within bucket 1, capital requirement for operational risk should be calculated as a simple sum of the capital requirements of individual banks (i.e. the sum of bank's specific Business Indicator Component) . Alternatively, we consider necessary to identify a corrective action to compress the super – additional effect present in the proposed methodology.

Annex 1 - Main features of the Italian Credit Cooperative Banks

Organizational structure.

Banche di Credito Cooperativo (BCCs) are standalone banks that have joined together to become a national horizontal network. The organizational structure can be defined as a two pole (associative side and business side) three-tier (local, regional and national) network.

The associative side is composed by 15 regional federations (which represent, promote, assist and monitor their member banks) and a national federation that provides overall strategy and policy guidelines.

The corporate side is composed of three Central Institutions (CIs) that provide wide-ranging support to the BCCs offering services and products specifically designed for BCCs.

Due to this structure, BCCs are able to offer customers a complete range of banking/financial products and services. Even the smaller ones can carry out retail activities (deposits, loans and payments services) and provide ancillary services to customers (in this case mainly SMEs) such as real estate financing, leasing, derivatives, interest rate swaps, etc. These latter services are primarily used by retail customers to hedge their own lending and foreign currency receivables.

According to a recent law (49/2016) the BCC network will soon be integrated in a Co-operative Banking Group.

Size of the network

The process of consolidation that has affected the Italian banking industry during the last two decades has led to the disappearance of many local banks which were incorporated into medium-large banks. Today BCCs represent the greatest majority of local banks. The average dimension of a BCC is 12 branches and 600 million euros of total assets. At the end of 2015 there were 364 BCCs with 4.414 branches (14,8 per cent of the total banking industry) operating in 2.293 municipalities. These are mostly small-medium sized urban centers. Members were more than 1.2 million.

From the operative perspective BCCs have a strong expertise in the activity of traditional intermediation, based on the *originate-to-hold* model and on long-lasting fiduciary relationships with customers.

Since the mid-nineties BCCs activity has experienced a steady growth which favored mostly their typical customers: small enterprises and households. At the end of 2015 9,6 per cent of the loans granted to Italian enterprises have been issued by a BCC-CR. The percentage rises significantly if referred to small enterprises employing less than 20 people. Also the share of financing to households has reached a significant level (8,5 per cent of the total banking industry).