



Indian Banks' Association

Corporate & International Banking

No.C&I/BII&RM/BIS/2010-11/ 2551

21st February, 2011

The Officer-In-Charge
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Dear Sir,

Comments on Consultative Documents

BCBS had come out with the two consultative documents as given below:

1. Operational Risk Supervisory Guidelines for the Advanced Measurement Approaches.
2. Sound Practices for the Supervision of Operational Risk

The above two consultative documents were deliberated in the IBA's Sub-Group on Risk Management at its meeting held on 12th January 2011. Based on this, IBA's comments on the above consultative documents were sent to our central banker, Reserve Bank of India. Now, we have been advised by our central bank to forward our comments to you directly, for your consideration.

Yours faithfully,

(K Unnikrishnan)
Dy. Chief Executive

Encl:

PARAWISE COMMENTS ON**A) BIS Consultative document on Operational Risk-Supervisory Guidelines for the Advanced Measurement Approaches****Para No. 14:**

The effectiveness of both the Corporate Operational Risk Management Function (CORF) and operational risk measurement system (ORMS) should be reviewed by appropriately qualified independent internal or external auditors, qualified external and/or other independent parties.

Para No. 16:

Verification of the ORMF is performed on a periodic basis and is typically conducted by the bank's internal and/or external audit, but may involve other suitably qualified independent parties from external sources.

Para No. 51(a):

Verification of the ORMF is done on a periodic basis and is typically conducted by the bank's internal and/or external audit, but may involve other suitably qualified independent parties from external sources.

Para No. 54:

Sound validation and verification activities present banks with important challenges:

- a) A bank must develop and maintain rigorous procedures for independent validation and verification of the ORMS and ORMF. Individuals performing the assessments should be competent and appropriately trained.

Our Comments:

It is stated in the above mentioned paras that banks to get the validation carried out by qualified external and or independent parties. But keeping in view the evolving nature of operational risk and general paucity of skilled staff in banks internally, as admitted by BIS paper vide para 54 (a), we are of the opinion that certain minimum criterion need to be fixed up by BIS /national supervisor.

Para No. 55:

A bank should establish clear and measurable objectivities for its verification and validation activities....

Our Comments:

In our opinion, verification and validation activities are normally qualitative in nature and establishment of clear and measurable objectives for verification and validation may



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not be feasible in an evolving area. Therefore, we suggest that the term "measurable objectives" may be clearly defined with little more granularities.

Further, verification and validation is proposed to be carried out on an ongoing basis leaving it open for the banks to decide the periodicity of these activities. We suggest that a minimum standard i.e. say minimum once in a year may be included in the guidelines.

Para No. 60.

Bank staff performing the verification/validation should be prepared to challenge management's view.

Our Comments:

Although, it may be very difficult for any staff to challenge management's view, particularly when it has emanated from top level, say Board / Management Committee/ Chief Executive, but still assuming that there is a difference in opinion of two sections i.e. risk management and independent validation department which is highly probable because of evolving nature of the operational risk area, document need to suggest actions to be taken in such circumstances.

Para No. 66

Verification plans, including procedures that will be used to test the ORMF, should provide for the following expectations:-

- b) Unlimited access to information.

Our Comments:

As has been admitted by BIS that operational risk is an evolving area, there are certain banks or vendors, who had taken early initiations and have been successful in creating models and frameworks. They may not like to share proprietary information of the models with any outsider due to business considerations. Therefore, it may not proper to include point No.(c), which says unlimited access to information. Instead, we suggest that para may include access to (1) Inputs, (2) Assumptions, (3) Processes and (4) Output may be shared with an outsider.

Para No. 85

(a) Direct charges including impairments to the statement on compromise income and write-down due to operational risk events.

Our Comments:

We seek clarification/explanation of the term impairment in operational risk. Does not mean damage to the asset?





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Para No. 86

The following specific items should be *excluded* from the gross loss computation:

- (b) Internal or external expenditures to enhance the business after the operational risk event: upgrades, improvements, risk assessment initiatives and enhancements;

Para No. 88(b)

Replacement cost: the economic impact of an operational risk loss usually differs from the accounting impact when losses affect assets or accounts that are not maintained on a mark-to-market basis such as property, plant, equipment or intangible assets. The gross loss amount is the replacement cost of the item. Replacement cost means the cost to replace an item or to restore it to its pre-loss condition.

Our Comments

It may be difficult to ascertain replacement cost in cases when it is decided not to replace or restore to pre loss condition. Some clarifications need to be included in the guidelines on such instances.

Para No. 87 (b). Rapidly recovered losses

Our Comments:

The committee may clarify the term rapidly recovered losses for maintaining consistency across the industry.

Para No. 101

Conservatism is necessary, for example, following a significant loss event, where a bank receives recoveries after a considerable delay. During this timing lag "gross loss" may represent a material impact on the comprehensive income statement. The prevalent practice of "gross loss amount after all recoveries (except insurance)" as a model input should be rigorously challenged in these circumstances. For this kind of loss event, it may be more appropriate to use the "gross loss amount" even when those losses are fully recovered.

Our Comments:

Period of "considerable delay" may be defined by the committee.

Modeling Para 164 to 171

Our Comments:

Committee may consider specifying that the materiality of a particular Business unit/Line can also be one of the factors for determining the level of granularity. This is particularly relevant as the "Segmental Financing Reporting" as per Accounting





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Standards considers materiality as one of the key element for determining a segment. Ultimately there may be a convergence between segmental reporting requirements (IFRS) and Basel II requirements (granularity of ORCs. Capital allocation).

Para No. 258,259

Use of BE&ICF in capital computation and its positive and negative adjustments.

Our Comments:

The committee may consider to specify examples of BE&ICF and adjustments thereof normally used by AMA banks for better clarity.

B) BIS Consultative document on Sound Practices for the Supervision of Operational Risk

Para No. 40 The bank should ensure the identification, consideration and incorporation as appropriate of the operational costs and risks of operational loss in the internal pricing, performance measurement and new product approval process for all significant business lines thereby aligning the risk taking incentives of individual business lines with operational risk exposures their activities create for the bank as a whole.

Our Comments:

As has been stated earlier also, operational risk is an evolving area and banks are putting up frameworks for different elements to be measured. Identification and measurement of operational cost and its linkage with pricing of products may need substantial past data history and experience. Therefore, we suggest to the committee to provide basic guidance by way of example for incorporation of operational risk losses and cost in pricing of products/services.

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