

February 25, 2011

Secretariat of the Basel Committee on Banking Supervision  
Bank for International Settlements  
CH-4002 Basel  
Switzerland

Dear Sir/Madam:

**Re: CBA<sup>1</sup> Comments on the Basel Committee's consultative documents:  
*Sound Practices for the Management and Supervision of Operational Risk, and  
Operational Risk – Supervisory Guidelines for the Advanced Measurement Approaches***

Thank you for the opportunity to comment on the Basel Committee's operational risk consultative documents. We acknowledge that "*Sound Practices for the Management and Supervision of Operational Risk*" is an update of an earlier version from 2003, and that "*Operational Risk - Supervisory Guidelines for the Advanced Measurement Approaches*" discusses preferred Advanced Measurement Approach (AMA) practices.

To meet the Standards Implementation Group Operational Risk's (SIGOR) expectation that banks will continuously improve their approach and the integration of their operational risk framework, we welcome the development of principles-based guidance to support banks as they develop and implement cohesive and meaningful operational risk management frameworks. We understand that these two consultative documents are based on the SIGOR's July 2009 review of loss data collection and range of practices. While we believe that Canadian banks are progressing in the development of effective operational risk management practices, we recognize that these documents reflect the evolving practices, approaches, and the need for further collaborative work between the industry and supervisors.

For your consideration, below is a summary of our key concerns with regards to the Basel Committee's consultative documents.

**Sound Practices for the Management and Supervision of Operational Risk**

This update of sound practices outlines eleven principles to foster a strong risk culture to support the development of the emerging discipline of operational risk, including the assessment of risk appetite. We believe that Canadian banks have made significant progress since the publication of the 2003 Sound Practices document, as we expanded our knowledge and experience in implementing appropriate operational risk frameworks.

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<sup>1</sup> The Canadian Bankers Association works on behalf of 51 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 263,400 employees to advocate for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The Association also promotes financial literacy to help Canadians make informed financial decisions.

Regarding a bank's operational risk governance structure as discussed under paragraph 37(b), we question the reference to an "*independent, non-executive board member*" on our Senior Operational Risk Management Committee, which is otherwise comprised of senior executives. We believe the paragraph is unclear in its current location. We recommend that this reference to the board of directors should be moved to the corporate governance section of the document. Otherwise, given its current placement, the reference implies the non-executive board member would serve on a management committee.

## **Operational Risk, Supervisory Guidelines for the Advanced Measurement Approach**

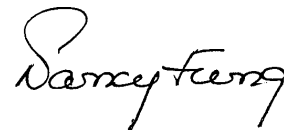
After reviewing the emerging operational risk practices, we understand that the SIGOR developed these guidelines to encourage a range of practices that are consistent with supervisory expectations. We appreciate that it provides useful additional guidance on governance, data, and modelling. It also provides further guidance on the application of the concept of three lines of defence in the assessment of operational risk: (1) business line management; (2) independent corporate review; and (3) independent review and challenge.

We support the goal to segregate the verification and validation roles from the model developers so that there is an effective independent challenge process for operational risk models. Similar to the Advanced Internal-Ratings Based (AIRB) credit risk framework, we believe that the risk management function could perform the independent operational risk model validation and operational risk profile verification functions. In conjunction, internal audit could assess the controls related to the verification and validation processes that have been implemented by the second line of defence.

We believe that there is a need for clear guidance regarding the expected role of the board in terms of attestation and whether or not they may delegate this function to a senior management committee. Currently paragraph 69 could be interpreted as placing an obligation on the Board itself to attest. Similar to current AIRB attestation processes, we trust that the general obligations on directors for diligence and assumption of responsibility are more than sufficient and that responsibility can be delegated to senior management. We recommend that the last sentence be amended from paragraph 69, so that it would read [new text is underscored]: "*Board Reporting: Results of verification and validation reviews (including senior executive attestation) should be summarised and reported annually (or periodically, as appropriate) to the bank's board of directors, or a committee thereof, for review.*" [delete: "...attestation. Attestation entails review and approval of the effectiveness of the bank's AMA and states that the AMA is working appropriately."]

We thank you for taking our comments into consideration and would be pleased to discuss these issues further at your convenience.

Sincerely,



cc: OSFI (Abhilash Bhachech, Brad Shinn, Bob Hassan, James Dennison, Aina Liepins)