# Sound practices for the Management & Supervision of Operational Risk – comments

## General Comments

Capital – capital planning is an important element of risk management. Yet you give too little attention to it, only mentioning it in @11 (and in @45 c).

Measurement of Operational risk – 'assessment' is more suitable, as in most of the time it encompasses real loss events with scenarios.

Legal risk – It is recommended to say a few words about managing legal risk as a part of operational risk – should there be a process of identification and assessment of legal risks with the same tools as for operational risks? Should they be identified with the same Event Type categorization as the operational risks? Or maybe just the outcome - the event loss, whenever legal, will be taken into account for the gross loss computation.

Some comments for the structure of the paper:

- There is a chapter by the name*: Principles for the management of operational risk*, and then there is a chapter by the name*: Fundamental principle of operational risk management*. It is not clear why the text was divided into these 2 sections.
- As well, it is not clear why the talk about the board of directors is divided between *' Fundamental principle of operational risk management' and 'Governance'.* It is recommended to consider putting them in one chapter.

## Specific Comments

@11. "the two notions" – it is not clear what notions you refer to.

@15. *… This function* <u>*may*</u> *include the operational risk measurement and reporting process, risk committees and responsibility for board reporting.* I think that the 'may' should be changed into 'should', especially for the reporting, which should be independent.

Comment 10 about the differences between risk appetite and tolerance is not clear enough. In both you mention the 'willing'. Also it is not clear what does 'the level of variation … around business objectives' has to do here. Usually, when setting thresholds or limits for operational risk, people do not think about it in terms of variation around objectives.

@22. Compensation should be put in a separated paragraph, because it is an important issue (as it was in the 2003 paper, @21 – remuneration policies). Also it is not clear how the compensation policies are connected to 'overall safety'.

@27 (c,d) – I think that thresholds should be connected to the residual risk only and not to the inherent risk, because only the residual risk is the one which is being managed.

@29 – what are the 'support' function?

@30 "the bank's level of risk aversion" – is it not equivalent to "risk appetite and tolerance"?

@32: the last sentence, beginning by – "*banks should be able to demonstrate…"* might better be placed after @19.

@37: this paragraph is more suitable to be under principle 1 or principle 2, as it talks about both board of directors and the senior management.

@39 (a): loss data collection is a very important tool for identification, assessment and monitoring of risk. It should be mentioned as 'should' and not as 'may', namely – 'the bank should collect loss data… '.

@39 (c): The last sentence is not clear: *Scorecards build on RCSAs by weighting residual risks to provide a means of translating the RCSA output into metrics that give a relative ranking of the control environment.*

Principle 8: The text focuses on reporting only. But monitoring is a common practice at the business lines, meaning the daily tracking for trends and for unexpected losses, for quickly detecting and correcting deficiencies. This should be more detailed, something like @26 & @27 in the 2003 edition.

As to reports, it is recommended to put back @30 of the 2003 edition: *In general, the board of directors should receive sufficient higher-level information to enable them to understand the bank's overall operational risk profile and focus on the material and strategic implications for the business.*

@47: about the five components of sound internal control program, they should be mentioned here in more details, and with the relevant application for operational risk.

@48 (c): it is not clear what should be done.

# Operational Risk – Supervisory Guidelines for the Advanced Measurement Approach - comments

## General Comments

There are many abbreviations. It is recommended to have a table of abbreviations at the beginning.

The abbreviation LDA is used for 2 different meanings: @36 - loss data. @167 – loss distribution approach. As the meaning of Loss Distribution Approach has become a common established abbreviation in the Operational Risk jargon (for example – the well known paper of Deutche Bank – LDA at work), I think that you should use LDA only for this meaning.

Stress tests have become a very popular instrument in risk management, especially after the 2008 crisis. I would suggest giving a few words about quantifying them and using them in the capital model.

I the chapter of Modelling, I suggest to say a few words about capital allocation to the business lines, after having calculated the capital for the institute as a whole.

## Specific Comments

@56 (f): How can we compare BEICF which is usually qualitatively assessed, with loss data

@ 57 (a): what is 'constructed data'?

@ 57 (b): the paragraph repeats the 5th bullet of @57 (a).

@72 what is the 'parallel run requirement' – where does this come from? Who will do the parallel run?

@84-86 – as you gave good definitions for 'gross loss', you should give a definition, or a list of what is included, for 'recoveries'.

@89 (b) There are events that generate gain, like errors in dealing rooms, that could have been as well a loss. Sometimes the errors are positive and sometimes are negative. The 'gain events' might in many instances give good estimations for the 'tails' of the loss distribution.

@99 – As the SIGOR allows 'gross loss amount' to be before or after recoveries, this might lead to a significant impact on the bank's capital charge. More clear

convergence of practice is needed, as it gives banks incentives to take the option of after the recoveries, which might lead to a smaller capital charge.

@192: If an event has had very large loss, after which strong control mechanisms have been set, so that such an event cannot occur any more, might this be recognized as an outlier? This is especially relevant for external data, for example the Sociate General event – might it be recognized as an outlier, which can be omitted from the calculation?  Many banks discussed the issue of whether to include this event in their database, in which case it increased their capital calculation significantly.

@252 : I would suggest to add a few words about the need to consider the relevancy of the ILD, for example, to think about omitting such events as emerging from processes or products that the institute does not use anymore, or omitting such event that after its occurrence a drawing of conclusion has been conducted and many new controls have been put on the process, so that such an event cannot occur anymore.