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SIG Operational Risk Sub-Group
Basel Committee on Banking Supervision,
Bank for International Settlements,
CH-4002 Basel
Switzerland
Email: baselcommittee@bis.org

Copy to: Tim Frech, FINMA.

Dear Sir,

Consultation Document : Operational Risk – Supervisory Guidelines for the Advanced Measurement Approaches

Thank you for the opportunity to comment on the above consultation document.

Credit Suisse has had AMA approval for its Operational Risk capital model since January 2008 and welcomes the opportunity to participate in the industry dialogue on improvements to operational risk capital modelling.

There are 2 key points we would like to highlight:

1. In the context of AMA modelling approaches, the paper is highly prescriptive. It makes a number of assumptions regarding the type of modelling approaches currently in use. For banks with a modelling approach outside of these starting assumptions, it is unclear as to how this guidance could apply without a fundamental change of model.

2. While we understand the supervisory view surrounding the recognition and recording of legal provisions, we reassert our litigation department's concerns that disclosure of reserve information on an individual case basis could lead to the identification of material matters. This could have an unintended and detrimental effect on a company's ability to defend itself and/or appropriately resolve litigation. We propose that such losses can be captured via scenario analysis in an AMA model, without the need to record specific losses in risk systems.

Further detail on the above key points and a number of other specific points are outlined below:

Introduction

Paragraph 3

The paragraph notes that banks accredited to use an AMA framework will not be affected by the observations and conclusions of this paper but then goes on to state that some AMA banks may need to amend their practices to reflect the paper's contents. These 2 points are contradictory.

Background

Paragraph 7

The last sentence in the paragraph requires further clarification. How has the Committee defined the range of effective and sound operational risk practices?

Verification and Validation

Paragraph 15, 51(b) and 52

We disagree with the assumption that the independent validation team would be in a position to ensure that the risk measurement methodology results in a credible estimate of operational risk capital that reflects the operational risk profile of the bank. Although independent validation teams can test the quantitative analysis and review results based on the input data available to them, they are not in position to determine whether the overall capital number reflects that operational risk profile of the bank. We suggest that this is rather the responsibility of senior bank management who will have the holistic view of the all risks facing the organisation.

Paragraph 15 and 57

There is significant overlap between the roles designated for the independent model validation team and internal audit. We propose that where review and verification is already being performed within the scope of an internal audit, (for example, review of internal controls, use test, reporting, role of senior management and organisational aspects) that this is not duplicated by the internal model validation team, who by the nature of their skill set, should be focused upon more quantitative aspects.

Paragraph 16 and 56(j)

These paragraphs refers to "Periodic assessments" – what is the recommended validation and verification cycle?

Paragraph 54 and 60

This paragraph states that the AMA validation team should be independent, meaning that they cannot influence the development and implementation of the AMA framework. Yet this is contradictory to the last bullet of 57(a) which notes that the validation team should be part of any new or modified model approval process. It also contradicts 57(c) which notes that issues and recommendations arising from the validation process should be appropriately considered and acted upon.

Paragraph 57(g)

Please clarify what is meant by "the relationship between the model's inputs and outputs are stable"?

Data – Date of Internal Losses

Paragraph 128 – 139, 186

We argue that it is not realistic to assert that a company can disclose litigation reserve information on an individual case basis and the identity of at least some of those cases will not be apparent. Even with attempts to anonymize the descriptions, the basic details of the case including business division and reserved amount could lead to the identification of material matters. Thus the disclosure could have an unintended and very detrimental effect on the company's ability to defend itself and/or appropriately resolve litigation.

We are already providing various regulators with thorough and timely information about our litigation and regulatory matters. There has been significant focus on this issue recently by both the SEC and the FASB.

Currently at Credit Suisse, litigation reserves and potential litigation losses are considered in scenario parameters discussions and thus already captured in our Scenario Based Approach to capital modelling. We propose that paragraph 135 and the recommendation to include the entire potential loss in scenario analysis is sufficient to meet the requirement of paragraph 133 to include legal related losses as an input into the AMA model. For Scenario Based Approaches, Scenario parameters are a direct input and inclusion is achieved without the requirement for specific details of litigation reserves being recorded and reported in the Operational Risk Loss dataset.

We completely disagree with the comment in Paragraph 139, which states that concerns over recording of legal provisions leading to unintended identification and disclosure of material legal matters lack credibility. This comment is impossible to square with U.S. litigation realities where plaintiffs suing public companies are able to review such companies' public disclosures and match the disclosures against specific significant reserve figures. We suggest that SIGOR solicit the views of counsel for public companies to discuss, in detail, the current realities of defending those companies in U.S. litigation and the consequences, for the defense, if plaintiffs were able to identify case specific reserve information.

Modelling

Distributional Assumptions

Paragraph 36 and 37, 172 – 224

These paragraphs are highly prescriptive and seem to be directing banks towards using similar OpRisk Capital Modelling approaches. Is this intentional? The paper makes a number of assumptions regarding the type of modelling approaches currently in use. For banks with a modelling approach outside of these starting assumptions, it is unclear as to how this guidance could apply without a fundamental change of model. Although we understand SIGORs preference for industry convergence, we propose that after only 3 years of modelling experience, it is too soon for specific approaches to be promoted over others.

Use of the four data elements

Paragraph 252 - 254

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We are surprised at the recommendation that External Data should be scaled. We have deliberately avoided scaling external loss data and consider that scaling methodologies such as choice of scaling factor or determination of which loss events to scale, can significantly impact the resulting loss data, potentially undermines its integrity and result in further divergence between firms. As an example, the size of a rogue trading loss may have no correlation with an institution's risk appetite, balance sheet scale or revenue size, yet one firm may choose to scale this data point by factor A, another firm by factor B and yet another firm may choose not to scale it at all. Our own experience is that scaling is generally arbitrary and unsupported by validation.

Again we appreciate the opportunity to comment on this paper and hope that all the industry feedback will be duly considered.

Please contact me if you would like to discuss any of the above points further.

Yours sincerely,

J. A. Dax

Jennifer Dax
Director
Bank Operational Risk Oversight

cc. Bret Cohen, Head of Group Regulatory Affairs, Credit Suisse Group
Philipp Rickert, KPMG