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December 31, 2014

The Basel Committee on Banking Supervision
Email: baselcommittee@bis.org

Dear Sirs,

The Basel Committee on Banking Supervision
Consultative Document «Operational Risk – Revisions to the simpler approaches»

On behalf of the Association of Russian Banks (ARB), and particularly the ARB Committee on Basel II standards and Risk Management, we would like to thank the Basel Committee on Banking Supervision for the opportunity to deliver our opinion on the Consultative Document «Operational Risk – Revisions to the simpler approaches» published by the BCBS on October 6, 2014 at http://www.bis.org/publ/bcbs291.htm.

We would like to thank the Basel Committee for its great job in promoting operational risk management and measurement practices. The proposed revised single standardized approach eliminates certain disadvantages of current ones. However it contains several issues for discussion. We hope our comments and answers be of use for further development of the prudent international regulatory framework and stimulate its implementation.

We would like to thank Dmitry Urazbakhtin and Oksana Zhdanova, members of the ARB Committee on Basel II standards and Risk Management, for their considerable contribution to preparing these comments enclosed (annex on 2 pages).

In case of further questions, please, do not hesitate to get in touch with us through e-mail: arb@alfabank.ru.

Zeyn ADAM

Co-Chairman of the Committee on
Basel II standards and Risk Management
The Association of Russian Banks

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№	Consultative question	Answer / Suggestion
1	Are there any other weaknesses in the existing set of simple approaches that should be addressed by the Committee?	Basel Committee has done a great job in promoting operational risk management practices. We would strongly recommend to benefit from already done QIS on Operational Risk (e.g. in 1998, 2000, 2002, 2008). The idea of existing approach is correct, i.e. to measure operational risk with respect to Gross Income. The only weakness is the decline in risk charge if gross income consequently decreases. As we understand that operational risk may only increase in crisis, the key proposal is to use maximum of actual (present) operational risk measure and that of historical ones. Thus operational risk capital charge will be non-decreasing solving for existing weakness.
2	Does a single standardized approach strike an appropriate balance across the Committee's objectives of simplicity, comparability and risk sensitivity?	In our point of view a proposed single standardized approach meets the BCBS objectives of simplicity and comparability. However in terms of risk sensitivity we recommend to link it not only to bank's size, but to a combination of its size and business structure.
3	Are there any further improvements to the BI that should be considered by the Committee?	We suggest BCBS to consider a possibility to link the BI also with the bank's business model, i.e. business lines structure.
4	What additional work should the Committee perform to assess the appropriateness of operational risk capital levels?	We recommend to review the quantitative methods used. Wrong statement is made on p. 37 (par. 46) that AIC and BIC are best suited to evaluate goodness-of-fit measures. This is only applicable for NESTED models. Regression models discussed below (including use of different, e.g. empirical, distributions) are non-nested. In that cases only goodness-of-forecast for loss value and loss frequency are applicable and appropriate. We also recommend BCBS also to compare operational risk capital level based on previous simple approaches and a proposed single standardized approach. Our last calculation shows that the capital level based on a new approach is slightly higher (by 10,4%) than based on previous ones. That could be an indicator of undervaluation of operational risk based on previous simple

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		approaches or overvaluation of operational risk based on a new proposed methodology.
5	Are there any other considerations that should be taken into account when establishing the size-based buckets and coefficients? How many BI buckets would be practical for implementation while adequately capturing differences in operational risk profiles?	The proposed approach definitely takes into account certain disadvantages of current simple approaches, but the question on the threshold values for buckets remains open. The thresholds for buckets are expressed in Euros. However for national economics (e.g. in Russia) all payments are made in national currencies (e.g. in Rubles). Due to the situation that exchange rate is constantly changing, this becomes possible that the same value of BI may fall into different buckets based on the different current exchange rates. We propose to allow local regulators to fix buckets in national currency, subject to review once in 3 years (similar to horizon for SIFIs set – 69 banks – fix) for developed countries and once per year for developing ones.
6	Are there any other considerations that should be taken into account when replacing business lines with size-based buckets?	We strongly recommend to stick to business lines to benefit from rich statistics collected during QIS.
7	Could there be any implementation challenges in the proposed layered approach?	New set of statistics should be collected that requires a certain time and resources.
8	Do the issues of high interest margin and highly fee specialized businesses in some jurisdictions need special attention by the Committee? What could be other approaches to addressing these issues?	No answer.
9	What would be the most effective approach to promoting rigorous operational risk management at banks, particularly large banks?	We recommend to engage more banks in BBB insurance against operational risks. Thus having close to full coverage insurance tool would be efficient as single bank could hardly with stand huge operational risk losses (please remember Barings case in 1994, LTCM – in 1998, Societe Generale – in 2007).