9 October 2014

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

Dear Sir / Madam,

RE: Consultative document: Operational risk - Revisions to the simpler approaches

I appreciate the opportunity to comment on the important operational risk capital calculation approach proposed in this report. Please find below my comments to the captioned consultative document:

Q1. Are there any other weaknesses in the existing set of simple approaches that should be addressed by the Committee?

- Income indicators such as GIs, and possibly the proposed BIs might not practically correlate with some of the Loss Event Categories, for instance:
  - Employment Practices and Workplace Safety
  - Damage to Physical Assets, and
  - Business Disruption & Systems Failures

- Regulatory fines and lawsuit compensations to clients might impact the GI, as results the relevant risk capital projections could also be underestimated

Q2. Does a single standardised approach strike an appropriate balance across the Committee's objectives of simplicity, comparability and risk sensitivity?

- It all depends on how well the proposed universal approach could replicate the operational risk capital profiles calculated directly with loss data through LDA

- In Asia , the main barriers of entry to LDA generally are:
  - Cost involved to implement the LDA simulation tool, and
  - Limited availability of specialists who equipped the right quant knowledge and day-to-day operational risk management experience in order to effectively operate such tool

  Hence, as far as the proposed simplified approach could be adopted without employment of specific technical capacities, it should not create much implementation concerns for non-AMA financial institutions.

Q3. Are there any further improvements to the BI that should be considered by the Committee?

- Regarding computation of OpCaR, for selections of severity distributions, apart from Log logistics and Pareto light you might also consider to incorporate Weibull distribution.

- Weibull is rather all-rounded sub exponential distribution generally fits well on different data sets and yields favourable Kolmogorov Smirnov test results

- Since the OpCaR did not incorporate scenario analysis/ BEICF hence the tail impacts could be diluted, OpRisk capital projected by the proposed approach could be possibly underestimated.

- Apart from selecting conservative choice of severity distribution we might consider to perform the benchmarking with a higher percentile confidence level e.g.99.95 to compensate the underestimation effect

Q4 & Q5. What additional work should the Committee perform to assess the appropriateness of operational risk capital levels?
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?

- As explained in this article, considered the nature and characteristics are significantly differentiated between the 3 proposed BIs (i.e. Interest component, service component, financial component), it might be more accurate to introduce 3 independent sets of "coefficient values" representing 3 different income components.

- The above could be done by recalibrating the OpCaR model through re-tagging/ separating all the available loss data into 3 BI components. This tagging process could be time consuming and field expert's judgements would be required (as explained in Q1). At the end 3 different OpCaRs should be simulated and 3 corresponding sets "effective" coefficients could be plotted for interest, service and financial BI components.

Q6. Are there any other considerations that should be taken into account when replacing business lines with size-based buckets?

- Currently under AMA we simulate loss distributions according to different business lines. Hence it might not be appropriate to totally neglect the business lines factors (despite the analysis concluded that they are not relevant under TSA). If we view this proposed simplified approach as the migration/ bridging model towards AMA's LDA, we should foster the standard that operational risk data should be formally categorised by business lines in order to anticipate future upgrade (i.e. to LDA) needs.

Q7. Could there be any implementation challenges in the proposed layered approach?

- The challenge generally resides on how to determine the correct sets of coefficient values rather than on implementation perspective.

- Once the right sets of coefficient values are defined, financial institutions should be able to adopt them easily, as the computation only involves simple summation and multiplications.

Q8. Do the issues of high interest margin and highly fee specialised businesses in some jurisdictions need special attention by the Committee? What could be other approaches to addressing these issues?

- This could possibly be addressed by introducing independent sets of coefficient values for Interest income BI, Service income BI and Financial income BI (as suggested in Q4 & Q5)

- Although netted interest / financial income figures might better fits the proposed calibration model, from practical point of view "netting" does not constitute operational risk mitigation effects.

- For E.g. financial expense on trading book could related to hedging which might contribute to mitigate credit/ market risk, while not necessarily impact the corresponding residual operational risk. On the other hand, there is possibility that Financial Institutions could abuse such netting impact to minimise their required operational risk capital.

- Considered interest / financial income and expense could possibly be correlated, we could consider striking the balance between "net" and "sum" by picking either the larger absolute figures (i.e. income or expense) for capital computation.

I will be happy to discuss my views further with you as appropriate.

Best regards,

Kenneth Ho
Associate Director, Operational Risk Management
Bank of Singapore, Hong Kong Branch
Office Email: Kenneth.Ho@BankofSingapore.com
Personal Email: Kennethho2012@gmail.com