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

June 1, 2016

**Re: BCBS Consultation on Standardised Measurement Approach
for Operational Risk**

Dear Sir/Madam,

China Banking Association (“CBA”) appreciates the opportunity to comment on the Basel Committee on Banking Supervision Consultative Document: **Standardised Measurement Approach for Operational Risk** dated March 2016.

China Banking Association (CBA) is a nationwide non-profit self-discipline organization of China’s banking sector. CBA serves for

the common interest of its members through the functions of self-discipline, rights protection, coordination and service so as to safeguard lawful rights and maintain market order of the banking sector, and promote the healthy and sustainable development of the industry. By April 2016, CBA has 585 members and 4 observers.

We greatly appreciate the great endeavors you have made to review and improve Standardised Measurement Approach for Operational Risk, as well as the opportunities you have provided to solicit the industry's comments on it.

On this important topic, we therefore have solicited member banks' main comments as below for your reference, which we hope can be helpful. And we sincerely appreciate the great endeavors you have made in the global financial regulatory reforms.

Yours sincerely,

A handwritten signature in black ink, reading "Yang Zaiping". The signature is written in a cursive, flowing style with some loops and flourishes.

Yang Zaiping

Executive Vice President

China Banking Association

Specific Comments

1. Main problems

1.1 Problem 1: There is no unified definition and standards for the loss data in the Consultative Document (hereinafter referred to as "CD"), so the banks have a large operating space when using loss data, leading to the measurement results are uncomparable.

Due to lagging and concealment of the loss of operational risk, some operational risk loss events will not be confirmed until years later, or even more than ten years' disposition, such as lawsuits. A bank can use loss data of different standards, such as cherry-picking from discovery date or accounting date, gross loss or actual losses, boundary losses with credit risk, setting different thresholds, etc. This may cause large variances in loss component. At present, guidelines of the Basel Committee in loss definition is not clear, so that banks have huge space in using loss data, different banks will use loss data of different standards, which will affect the comparability of measurement results.

1.2 Problem 2: The monotone increasing relationship between capital requirements and loss amount in SMA will disincentivise banks to collect internal loss data, and will thereby affect the

effective use of risk management tools, leading to disconnection between the operational risk measurement and management.

The capital requirements in SMA increases monotonically with the growth of the loss amount, and when the total amount of loss are same, banks with higher proportion of large losses will face higher capital requirements, therefore, banks are incentivized to hide loss events.

This means that with the inadequacy of the loss data collected by a bank, especially large losses, capital requirements will decline. Especially when the total loss amount is already large, concealing large losses will bring a significant reduction in capital requirements. Since the loss data is negative information, banks are naturally reluctant to report it. In addition, the inevitable increase in capital requirements may further drive the bank to reduce collection of the loss data. The lack of loss data will affect the risk assessment, indicator monitoring, risk analysis and other work based on loss data, and reduce the effectiveness of risk management.

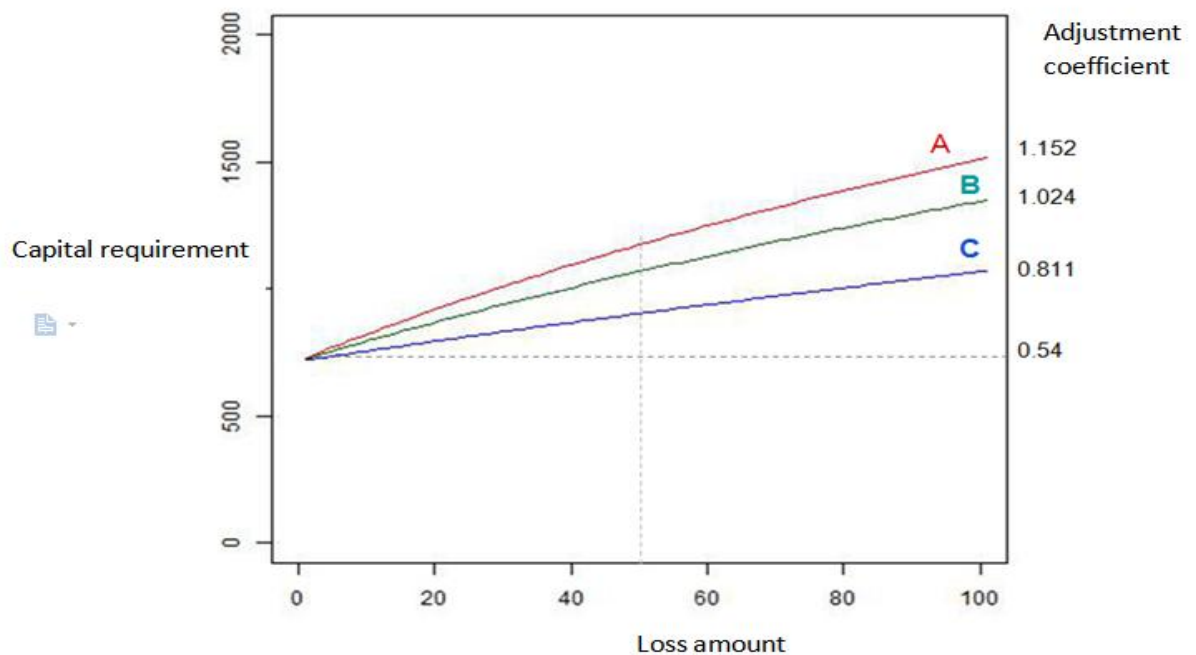
In fact, in the current AMA (LDA) framework, it is not always that larger loss amounts lead to higher capital charge. Instead, AMA introduces RCSA, KRI and other management tools as BEICFs into models, such as setting the beforehand key risk indicators (eg key staff

turnover) as input data, which can not only reflect the changes of risk environment and risk management, and prejudge the risk in future, but can also encourage banks to implement these tools for using the advanced measurement approach. At the mean time, Basel II has set higher qualitative and quantitative standards for the AMA, and the banks need to implement the AMA in the aspects of governance, policy system, data system and so on. Therefore, once SMA incorporates losses into capital charge, it should consider a wider range of expectations on banks' qualitative management factors.

As to the banks which can not meet the condition of the loss data collection, the CD prescribes that the adjustment factor should be 1.0 at least, which results in that banks with big loss data (adjustment factor is greater than 1.0) could claim that they do not reach the standard of loss data and use 1.0 as the adjustment factor directly, and thus artificially lower capital requirements. In this regard, the CD proposed that regulatory authorities should ensure banks to adjust business indicators component and make disclosure on the adjustment. The practicability of this arrangement is questionable, especially in countries with a large number of banks, because it's difficult for regulatory authorities to grasp bank's other loss data except the large internal and external fraud events.

1.3 Problem 3: The impact of tail data is too large, which may cause large fluctuations in the capital in a given year, and trigger banks' motivation to manipulate data.

The CD takes an average of three years of the internal loss data, and sets the weight of 19 times on the loss amount of more than 100 million Euros. This approach takes into account the impact of tail loss, but the occurrence probability of the loss of such risk events is very low, such as Societe Generale and UBS trader fraud event, may be once in ten years or once in a hundred years. Current practice has only impact on the three years before and after, and will lead to intensive fluctuations on capital in a few specific years. On the other hand, under this approach giving higher weights to large losses, in the same total amount of loss data, banks with less large loss will face less capital requirements, as shown in below graph. When the annual average loss is 5 billion CNY, the impact of loss data structure on the adjustment coefficient could be up to 30% at most, and the impact on the capital requirements could be up to 27 billion CNY. When the annual average loss is 10 billion CNY, the impact of loss data structure on the adjustment coefficient could be up to 42 % at most, and the impact on the capital requirements could be up to 44.4 billion CNY. Banks have motivations to revise data (such as splitting large losses into small amounts) to reduce capital requirement.



Notes:

(a) A line is for all losses that are more than 100 million CNY, the B line is for all losses that are between 10 million CNY to 100 million CNY, C line is for all losses that are less than 10 million CNY.

(b) BIC is 131.4 billion CNY; unit: 100 million CNY

(c) When the amount of the loss is 0, the adjustment coefficient is 0.54, saving about a half of the capital.

(d) When the loss amount is 5 billion CNY, if losses are all small, the adjustment coefficient is 0.69, capital requirements is 90.3 billion CNY; if losses are all large, the adjustment coefficient is 0.89, an increase of 30%, capital requirements is 117.3 billion CNY, an increase of about 27 billion CNY.

(e) When the loss amount is 10 billion CNY, if losses are all small, the adjustment coefficient is 0.81, capital requirements is 106.8 billion CNY; if losses are all large, the adjustment coefficient is 1.15, an increase of 42%, capital requirements is 151.2 billion CNY, an increase of about 44.4 billion CNY.

1.4 Problem 4: As to the large banks, the requirement of the loss data quality for SMA is not less than AMA. SMA still need a set of effective mechanism to ensure the integrity of the loss data. SMA is only a mathematical simplification, its accuracy of measurement

and risk sensitivity is far less than AMA.

From the practice of banks, the high-frequency-low-loss data accounted for 20% to 30% of the total loss, and if there is not a set of effective mechanism, even if banks have the will to collect loss data, this part of loss data will probably be lost. It is important that SMA set for more implementable standards that ensures a sound and comprehensive loss data collection mechanism.

2. Suggestions

2.1 It's suggested to further clarify the definition of operational risk losses, as well as related loss standards, to ensure that all banks collect data under the same standards in order to improve the comparability among different banks. In addition, it is recommended that credit risk loss caused by operational risk is not included in operational risk loss, so as to avoid repeated capital measurement.

2.2 It's suggested to stretch periods of the loss data used in computing Loss Component to five years or longer, or reduce the weight of large losses appropriately, to prevent such tail loss from causing intensive fluctuations of capital requirements.

2.3 It's suggested to clarify supporting regulatory requirements in SMA, such as regulatory authorities conduct regular supervisions and inspections on banks' loss data reporting, and set up punishment mechanism for concealing operational risk losses, to prevent

manipulating data to artificially reduce capital requirements, and to ensure the management and technology comparable when measuring different banks' capital.

2.4 Introduction of internal loss data adjustment factor is actually the logic of AMA, so it's suggested that to divide SMA into two levels, and set qualification criteria respectively. In the first level, the capital requirements will be calculated based on business indicators; while in the second level, the internal loss data adjustment factor could be introduced, implemented by banks only when reaching qualification standards. The gradient of the measurement system should be maintained and banks are encouraged to take initiatives to strengthen operational risk management.

2.5 It's suggested to further clarify the rules for group consolidated calculation of BI. For example, when calculating BI under group caliber, the parent company's trading business make profits while the subsidiary company's trading business suffer a loss and the loss is directly derived from the transactions between parent company and the subsidiary, how to deal with this situation?