

31 May 2016

Mr Mitsutoshi Adachi
Chair, Working Group on Operational Risk
Basel Committee on Banking Supervision (BCBS)
Centralbahnplatz 2
Basel, Switzerland

Dear Mr Adachi

Consultative Document: Standardised Measurement Approach for operational risk

1. DBS is pleased to have the opportunity to comment on the BCBS' proposed Standardised Measurement Approach (SMA) for operational risk.

SMA is a better approach than the previously proposed revised SA

2. DBS agrees that the SMA represents an improvement over the previous revised standardised approach proposed in October 2014 in terms of risk sensitivity. The current approach takes into account the historical loss experience of a bank which is a close proxy indicator of the effectiveness of operational risk management.
3. We believe that the proposed SMA can be further refined, in a way that retains simplicity, embeds greater risk sensitivity and ensures greater comparability. We set out our suggestions in the following paragraphs.

Proposed SMA is heavily skewed towards revenue/size; a higher weightage should be accorded to the effectiveness of a bank's risk management

4. Under the proposed SMA, the Business Indicator Component (BIC) element is accorded significantly higher weightage than the Loss Component (LC).¹ We would argue that a higher weightage accorded to the LC relative to the BIC would encourage banks to improve their risk management. Increasing the sensitivity of SMA to losses may be achieved, for example, by allowing for a greater range in the multiplier. A simple adjustment K can be applied to the multiplier as follows:

$$k * \ln(\exp(1) - 1 + LC/BIC) - k + 1, \text{ where } K \text{ ranges between } 1 \text{ to } 2$$

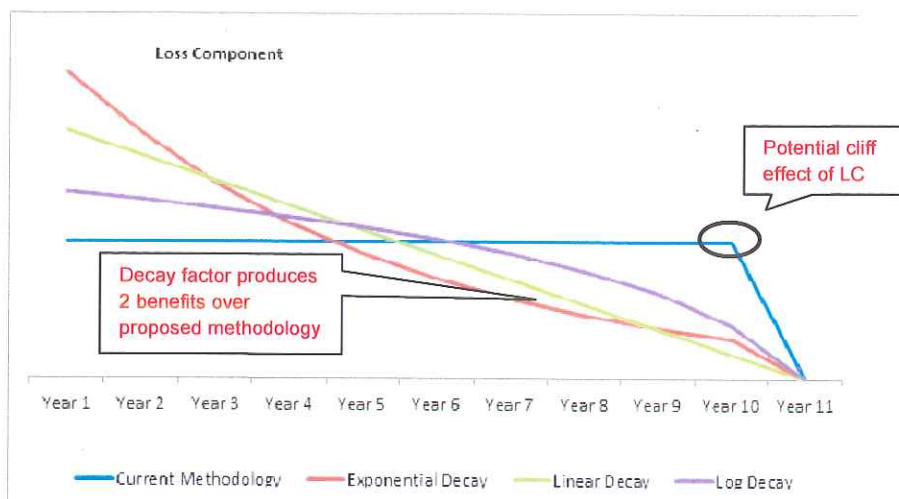
5. We note that the proposed capital computation under bucket 1 is based solely on the BI component. We do not think bucket 1 banks should be carved out and they should also be required to use internal losses. This will, amongst other things, incentivize them to build and maintain a loss database.

Decay factor should be introduced into the LC

6. The calculation of the LC under the SMA takes into account loss data for 10 years and treats all losses within the 10 years as equally relevant for the current risk profile of a bank, regardless of whether a bank's risk management practices have improved. We are of the view that a single large loss (or a bank with a single large loss) incurred 10 years ago, and a single large loss (or a bank with a single large loss) incurred 1 year ago, should not be treated the same.

¹ That is, the elasticity of SMA to BIC ($\frac{\partial SMA/SMA}{\partial BIC/BIC}$) is always higher (sometimes much higher) than that of LC ($\frac{\partial LC/LC}{\partial LC/LC}$).

7. As recent losses are more reflective of a bank's risk profile, a time-weighted factor could be introduced in the LC. Time-weight functions that can be considered include exponential, linear and log decay functions. A log function reduces the weightage of a loss event in an accelerated fashion over time. The log function has the additional advantage of reducing potential "cliff effects". This is illustrated in the chart below.



8. In the event where there is a one-time significant operational risk loss, we are conscious that there will be an impact on the profit & loss as well as a commensurate increase in the capital for the bank. To prevent time-weighting from overly penalizing a bank that recently experienced such a loss, the weight of the immediate past year can be lowered or the loss amount omitted altogether.

Insurance

9. The mitigating effect of insurance should be considered under the SMA. This could be achieved by allowing certain insurance recoveries and/or capital relief through adjustments in the LC for operational risks which are already insured.
10. We trust that our comments, along with the more detailed ones in the Appendix will be useful for BCBS' analytical work in this area.

Yours faithfully



DYLAN LEE
HEAD, RISK MANAGEMENT GROUP – OPERATIONAL RISK
DBS BANK LTD

Business Indicator (BI)

1. The adjustment on the Services Component for high fees is intended to address over-capitalization of banks with high fees component. However, for institutions with higher fee income relative to fee expense, the adjustment to reduce over-capitalization becomes negligible i.e. beyond a certain size, the net fee income floor becomes the dominant driver of BI. The rationale for recognizing net fee income only past a given size (and gross fee income before that) as well as how the size is determined should be clarified.
2. The following clarification on the BI definitions (Annex 1) is required:
 - a) Do the BI definitions take into account the implementation of new accounting standards (e.g. the standards on Leases, effective 1.1.2019)?
 - b) Are revenue-related expenses (e.g. sales incentives, business taxes) within the scope of fee and commission expenses?

Internal Loss Multiplier and Loss Component (LC)

1. There is no explicit mention that the loss data used to compute the LC should be based on Net Loss (as opposed to Gross Loss). The final rules should specify the basis of the loss data.
2. Operational risk losses are included under both BI (Other Operating Expenses) and LC. We suggest that operational risk losses be excluded from BI to eliminate double counting.

The SMA Capital Requirement

1. As the Bank currently computes and publishes its Pillar 3 disclosure on a quarterly basis, should the BI and loss data be based on rolling financial quarters (as opposed to rolling financial years)?

Minimum standards for the use of loss data under SMA

1. The loss dataset includes "material timing errors" which span more than one "financial accounting period". For clarity, the final rules should provide a specific threshold for materiality and a clear definition of financial accounting period to ensure consistency of interpretation and application.
2. There is no mention of whether rapidly recovered losses should be included or excluded from the loss data set. The final rules should provide clarity on this.

Annex 2 Example of an alternative method to help ensure the stability of the SMA methodology

1. In the alternative formula suggested, calibration of the factor "m" becomes a critical consideration to determine at what point should the relativity between LC and Business Indicator Component (BIC) have a higher rate of reduction in the multiplier. For example, values of "m" between 1 to 1.6 will see an increase in the multiplier for most LC/BIC ratios below unity (when compared to the Ln function), but for LC/BIC ratios beyond unity, the multiplier converges to "m". In view of the added complexity in calibration, this formula seems inferior to the Ln function proposed.