8 January 2015

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

Dear Mr Adachi

Consultative Document: Operational Risk – Revisions to the Simpler Approaches

DBS is pleased to have the opportunity to comment on the BCBS' proposed revisions to the simpler approaches for operational risk.

Methodological issues

2 As calibrated, the primary driver of operational risk capital in the proposed new standardized approach (SA) is firm/revenue size, and there is no room to take into account other pertinent considerations such as the quality of a bank's operational risk management. Two banks could be of the same size and the SA would have compelled them to set aside the same operational risk capital, although different standards in each bank's operational risk management practices could have resulted in dissimilar loss experiences.

3 We would also continue to encounter the issue of increases in income that have resulted from factors that do not, in themselves, bring about operational risk. One example would be the impact of an interest rate hike on interest income/NIM. As part of its work in evaluating the constraints faced by banks with high NIMs, the BCBS could perhaps through its proposed QIS look into this in greater depth.

Managing the capital impact

4 The proposed parameters in the SA are likely to increase operational risk capital levels across the industry. In itself, this assumes that holding more capital is always the most optimal response in managing operational risk, which is not the case. DBS' experience is that the existing operational risk capital charge is already way higher than our historical operational risk losses. This reflects in part a further "grossing up" effect as Basel III has also stepped up minimum capital requirements.

5 We believe that there is a need for an alternative methodology that would give adequate recognition to the quality of a bank's operational risk management practices,

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as well as their historical loss experience which would be a direct reflection of a bank's risk management standards. For example, banks which have recorded cumulative operational risk losses in the last 5 years that are less than a certain percentage of their cumulative revenue (supplemented by other criteria, qualitative or quantitative, which the BCBS could specify) would be allowed to avail themselves of a separate calibration with lower parameters, shown under the 'Alternative' column in the table below.

Business Indicator (euro, millions)	**Capital requirement**	
	BCBS proposal	*Alternative*
0-100	10%	10%
100-1,000	13%	12%
1,000-3,000	17%	14%
3,000-30,000	22%	16%
>30,000	30%	18%

6 The capital requirement at the starting point is aligned to 10%, and the final tier charge of 18% is the highest coefficient under the existing standardized approach before the big global banks were fined for financial misconduct and market manipulation. Aside from being a more meaningful calibration of capital requirements, we believe that the availability of an alternative creates the right incentive for banks to improve their operational risk management practices, and also gives adequate recognition to banks that have business models that would not lead to the headline-grabbing losses.

7 While a more minor point, we also note that the use of Euro-denominated tiers could introduce unwarranted foreign exchange-induced volatility in the capital requirements of banks that do not adopt the Euro as their functional currency. There should be adjustment mechanisms made available to manage this impact.

Conclusion

8 We trust that our comments, along with the more detailed ones on specific annexes in the Consultative Document as attached in the appendix, will be useful for the BCBS' further analytical work in this area.

Yours faithfully,

CHNG SOK HUI
CHIEF FINANCIAL OFFICER
DBS BANK LTD

Appendix 1

Annex 1: Definition of the Business Indicator

1. The final rules should define the sub-item "foreign transactions" under the "Fee and Commission Income" and "Fee and Commission Expense" and relevant examples should be provided.

2. Outsourcing expenses were mentioned in both "Fee and Commission Expense" and "Other Operating Expense". The intended distinction between fee-based and non-fee based outsourcing expenses is not clear as outsourcing typically relates to services performed and is hence largely fee-based. The final rules should provide for examples for expenses paid for outsourced financial services and non-fee based outsourcing expenses.

3. The final rules should address the appropriate treatment for gains or losses arising from "one-off" activities (e.g. disposal of a subsidiary or associate).

4. We note that dividend income is to be excluded from the Business Indicator. The final rules should explain the appropriate application for banking groups with subsidiaries and associates.

5. Expenses on share capital repayable on demand are to be excluded from the Business Indicator. The final rules should clarify if this is meant to cover expenses related to redemption which are share capital at entity level but non-controlling interest at group level.

6. The final rules should confirm whether accounting definitions apply to the line items used (e.g., "Realised net gains/losses on financial assets and liabilities ...", "Net gains/losses on derecognition of financial assets, non-financial asset, liabilities...")

7. The final rules should explain whether the list of items in Annex 1 is illustrative or exhaustive. For example, we would like to understand the appropriate treatment for "Direct charges to the P&L and costs incurred as a consequence of operational risk events ... which have not been provisioned for in advance" - in the event there was a provision made.

Annex 3: Investigation of 20 potential indicators of operational risk exposure

1. We note that on page 32, there appears to be an error with the interpretation of R^2 given the specification of a linear regression without an intercept. Orthodox statistics will note that if a regression has no intercept then the R^2 (or adjusted R^2) is not an appropriate measure of goodness of fit.

Annex 4A: Loss data collection

1. With reference to paragraph 2, we request that the final rules provide guidance for the term "rapidly recovered" e.g. the time horizon (e.g. no. of business days) such losses would be expected to be fully recovered.

2. With reference to paragraph 4, we note that the recent Basel III monitoring exercise stipulated that losses should be reported on the basis of the discovery date or accounting date of the loss event; any subsequent loss adjustments (including recoveries) should be based on accounting date and reflected in the subsequent years.

   We are of the view that it would be more appropriate that loss adjustments be recorded in the original period when an incident is first discovered as this would:

   a) more accurately reflect the actual net loss amount of the incident especially if such adjustments are material; and

   b) be more reflective as these adjustments relate to an incident which has happened in the past and the control environment at that point in time. It would not be appropriate to report these in subsequent years as the control environment may have since improved.

3. With reference to paragraph 5, in order to ensure consistency, definitions and basis for recording need to be provided in the final rules for near misses and opportunity costs/loss revenues.

   With regard to recording of opportunity costs/loss revenues, it is difficult to quantify such amounts objectively and hence consistency and comparability will be difficult to achieve. If recording of opportunity costs/loss revenues is deemed a requirement, explicit guidance would be required in the final rules to ensure consistency in implementation across banks.

4. With reference to paragraph 9, the final rules should seek to clarify on the rationale for reporting the sum of 5 largest losses (instead of, say, 3 or 5 losses), i.e., would the information be intended for statistical/modelling or other purpose.

Annex 4B: Operational risk management

1. Annex 4B is largely similar to Basel's Principles for the Sound Management of Operational Risk (PSMOR). As stated in Executive Summary of the consultation paper, the PSMOR "provide comprehensive guidance regarding the qualitative standards that should be observed by large internationally active banks". Instead of highlighting some of the principles from PSMOR, we suggest that Annex 4B should reference the PSMOR.

2. With reference to paragraph 3, the final rules should state if such thresholds are to be quantitative.

3. With reference to paragraph 6, the final rules should explain the rational for business line mapping since the proposed capital computation methodology does not require this. Moreover, it contradicts Paragraph 30 to 32 of the consultative document on the weakness of using the business line dimension: (1) not risk sensitive (2) assignment of weightage is flawed (3) no longer relevant to the way business lines are organised, e.g. new products/channels.