

4 January 2015

Via Email

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

We are pleased to submit our comments to the Basel Committee's Consultative Document on "Operational risk – Revisions to the simpler approaches" (the Paper). We agree with the focus of the Committee's work and welcome the initiative to improve the calibration of operational risk requirements.

General Comment

We support the work undertaken by the Committee and the analysis performed. Our comments below are focused on smaller institutions and highlight the need to consider the appropriateness and applicability of the analysis for firms which significantly vary in size, complexity, scope of activities and nature of operational risks.

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

We support the rationale for the review of the simpler approaches (as specified in the Paper) and agree with the potential scenarios under which the present approach inadequately reflects operational risk. We believe that operational risk approaches should be risk sensitive and we note the weaknesses identified in the Paper. In addition, we have reservations in relation to the averaging Gross Income (GI) of previous annual results. Such an approach may remove an element of sensitivity to real developments in the underlying operational risk profile of the bank and may not be adequately representative of present and emerging operational risks. Overall, however, we recognise that other proxies for the riskiness of a bank in this area tend to pose similar difficulties. The application of the simple approaches needs, therefore, to allow adequate flexibility for supervisors to be able to address real developments.

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

We agree with the need to strike an appropriate balance across the Committee's objectives of simplicity, comparability and risk sensitivity. Whilst in principle a single standardised approach may achieve these objectives, we believe that it is difficult to ignore the fact that some business lines carry with them heightened operational risks and that certain features of the business model, such as the extent of IT investment and outsourcing, may amplify or mitigate operational risk.

We also note the pace of change in the banking industry together with heightened risks in relation to compliance failures. With the use of historic loss information in the calibration of the simpler approaches, there is a need to revisit and recalibrate the approaches periodically to ensure that operational risk requirements adequately capture structural shifts and new risks. The need to ensure continually that the simple approaches remain relevant and to, therefore, co-ordinate timely updates across many jurisdictions is potentially a disadvantage of the approach.

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

See our response to question 8.

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

We believe that it is important that the Paper covers analysis performed across a population of banks which differ in size.. However, it is not clear whether the explanatory strength of BI or the size-based buckets is adequately representative of smaller banks with BI lower than €100m, which are based in varying geographical regions, such as smaller banks operating in emerging markets.

Q5. 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 "lower than €100m" size-based bucket will capture a significant number of banks and in some cases may cover the entire population of banks in a given jurisdiction. All such institutions would, therefore, be allocated a size-based coefficient of 10%.

In this light, some consideration may be necessary as to whether this coefficient appropriately covers such a wide range of firms and jurisdictions. For example, additional consideration may need to be given to other factors impacting the operational risk profile of banks falling within this bucket. This is to account for potential understatement or overstatement of operational risk which may arise from typical business model features such as cross-border outsourcing of technology and services to third parties, which might heighten operational risk.

Moreover, the analysis in the Paper does not clarify whether loss experience data collected in order to determine the strength of proxies also covered operational risks and losses stemming from third party outsourcing. In particular, the Paper does not appear to address the possibility that certain third party-incurred losses may not have been reported to the loss reporting bank, and were consequently not captured in the Committee's statistical analysis.

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

Please refer to our response under Question 8 below.

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

We have no further comments to add.

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?

We are very supportive of the additional work proposed by the Committee in respect of banks facing very high or very low net interest margins (NIMs) and small banks highly specialised in fee business. Based on our general observations many banks in emerging markets tend to have relatively high NIMS, but this does not, in our view, necessarily directly correlate with higher operational risk. We believe that additional attention may be required to examine the appropriateness of such an approach for banks operating business models conforming to Islamic principles.

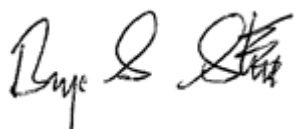
Banks managed from jurisdictions which operate under differing accounting and revenue recognition principles may also require additional examination. Banks may adopt accounting treatments which significantly impact payment structures, income recognition and fair value treatments and ultimately the overall calibration of BI. The final proposal should therefore strive to achieve definitional consistency of core income statement line items forming the basis of BI.

We note that the approaches could include caps, floors and supervisory judgement in order to address the problem of calibrating appropriate operational risk requirements for banks with very high or low NIMs and fee business. We also believe that other approaches may include a variant on the business line approach in order to differentiate between certain types of fee business and low NIM firms. A Pillar 2 type arrangement should also be implemented to account for risks not specifically included in the calibration of the simpler approaches to afford supervisors appropriate flexibility.

Q9. What would be the most effective approach to promoting rigorous operational risk management at banks, particularly large banks?

We continue to support the Committee's Principles setting out qualitative expectations for the management of operational risk. We believe that the implementation of the Principles should continue to be commensurate with banks' size, complexity and activities. Importantly, as banking systems continue to change and industry practice evolves, banks must address the new risks that arise by continuously improving their operational risk management.

Yours sincerely,



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