Attachment

Saudi banks comments on BCBS Consultative document Entitled "Operational Risk – Revisions to the simpler approaches"

Bank # 1

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

The current approach does not deal well with rapidly growing businesses as the averaging approach may lead to an under estimation of the underlying operational risk.

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

The adoption of a single standardized approach is supported as it will provide external parties with a consistent basis on which to assess banks within a single country or globally.

Q3: Are there any further improvements to the Business Indicators (BI) that should be considered by the Committee?

It is recommended that the committee consider the inclusion of an 'add on' factor which will weight the relative level of maturity of a Banks Internal Control Framework. This could be applied by establishing a set of benchmarks that would be independently assessed (by the regulator or a third party) with the outcome leading to a rating that would drive the amount of the add on buffer to be applied.

For banks that have a well established and mature framework, a nominal buffer would most likely suffice. However for banks with a less sophisticated or under developed framework for their size and complexity, a larger buffer would be necessary.

This would incentivise banks to invest in developing and maintaining a strong Internal Control environment as a means of minimising operational losses.

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

It is recommended to undertake a comparative assessment across conventional as well as Islamic banks to ensure the BI metrics are calibrated to capture the differing operational risk characteristics.

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 size based buckets are fixed and thus may not be sustainable over time due to the effects of inflation. Empowering local regulators to apply a form of indexation may be considered to cater for this.

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

The removal of business lines may create the risk that the markedly different operational risk characteristics of a retail business (high volume, and lower value) compared to a corporate based business (lower volume and high value) are lost in the new measure.

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

Based on the current proposed BI approach bank does not see any implementation challenges, as the data required to calculate the BI is currently available from published sources.

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?

The committee may wish to consider setting minimum floor levels on the indicators to ensure that the inherent risks are captured irrespective of the business mix.

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

Cultural and mind set driven by setting a clear "tone from the top" and alignment with organisational values and reward structures.

The establishment of an effective training and development programme to initially educate people on their obligations under operational risk and then to run periodic refresher activities. These activities may also be tailored to provide formal accreditations for operational risk professionals as well as certifications for Business managers.

Peer comparison or benchmarking activated through pooling of country or region level operational loss data. This will provide transparency of the inherent levels of risk within a country or region as well as highlighting banks that operate with a materially higher level of risk. This could also be supplemented with industrywide review forums which may also include regulator participation to enable sharing of best practices, across the industry.

Periodic independent review by a third party or internal auditor to validate process controls, loss reporting and governance practices. This will provide management with a quality assurance on the effectiveness of the operational risk activities.

Bank # 2

We reviewed the "Consultative document on Operational Risk – Revisions to the simpler approaches" and observed that the Business Indicators as suggested are focused mainly on financial metrics which may not always be an accurate proxy for the operational complexity and the risk to which a bank is exposed e.g. complex high value transactions which may result in only a nominal net fee income (due to importance of relationship, etc.) will not be assigned the same weight as simple high volume smaller transactions which attract relatively less operational risk.

Bank # 3

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

A1. The existing approach is not considering the following factors which might be vital factors in building Operational Risk capital:

- Historical Operational Risk losses and scenario analysis in calculating Operation Risk capital.
- Financial Circumstances (e.g. market stability and bank expansion).

The calibration of regulatory coefficient is applied on Basel's eight business lines, while some banks have different structure. This may cause a chance of being overcapitalized or undercapitalized.

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

A2. The current approach has an appropriate balance in case of simplicity and comparability as there are no complicated requirements in terms of calculating the minimum capital requirements and distribution of capital across the eight business lines.

However, the committee needs to pay more attention in regards to risk sensitivity for current TSA/ASA. This kind of factor will give a comfort to banks who are very concerned for some sensitive risks by embracing this essential factor in evaluating the adequacy of capital framework.

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

A3. The new BI is more comprehensive reflecting some elements that have direct effect on operational risk capitalization such as operating expense and net P&L on banking book. However, these new elements might overcapitalize the operational risk capital. Therefore, we recommend the committee to select randomly some banks to apply the new suggested BI and eventually to assess the result of the adequacy of capital framework.

In addition to the proposed BI, the operational risk losses should be considered in calculating the capital to give a cohesive estimation of capital in order to assess the appropriateness of operational risk capital levels.

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

A4. The committee should evaluate the effectiveness of new methodology on banks operational risk capital charge by comparing the result of new operational risk capital to current approach result and realize the consequence of new approach to related factors (e.g. Capital Adequacy Ratio "CAR").

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?

A5. We recommend to consider banks who are relying on high interest margin and high fee before establishing the proposed size-based buckets and coefficients. These type of banks will have higher proxy indicator result (i.e. BI) than current proxy indicator result (i.e. GI), which might overcapitalize the minimum capital requirements.

The proposed BI buckets in terms of number and size range are well structured. However, the committee needs to redefine/ decrease the BI coefficients to avoid the overcapitalization of the mentioned type of banks (i.e. high interest margin and highly fee specialized banks).

Note: *suggested coefficients have been stated in Q.8.*

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

A5. As banks' size is ranged between small to large and since the size-based bucket might not be applicable for some banks especially for small size as their BI will be within the first bucket. We recommended that BCBS allow central banks to define/customize their own size-based buckets that suitable for them.

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

A7. Challenges could appear during the implementation of new revision approach. So it is preferable to start implementing the new revision for selected banks to see the impact from the new capital model and how this new revision will affect the adequacy of capital framework.

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

A8. A Bank which depends on high interest margin or high fee will be exposed to overcapitalization. It is suggested for those banks who highly depend on interest margin or fee to use the proposed approach with changing the coefficient per bucket respectively 9%, 12%, 16%, 20% and 25%.

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

A9. For large banks, the AMA is the most effective approach as these banks are more exposed to operational risks than other banks which are medium to small size. For mid and small size banks the revision approach will be most effective if the following actions have been taken:

- Evaluating the operational risk framework.
- Having a comprehensive RCSA and KRI.
- Establishing a clear system in capturing losses.

Bank # 4

Based on our review we have the following comments:

- The committee may consider introducing different regulatory coefficients for interest, services and financial components subject to national discretions. These different components in BI will have varying degree of operational risk depending on the size, complexity and geography of a bank.

- The committee could explore the applicability and effectiveness of the new approach for Islamic products based on operational risks relating thereto.

Our responses to the specific questions posed in the document are as follows:

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

Response - The main issue with the capital charge under BIA is that it increases linearly with the increase in Gross Income without any relation to the actual losses suffered.

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

Response -The proposed approach is simple, risk sensitive (as capital charge will increase along with actual operational losses or activities in the bank as captured by Business Indicators through fees, and other charges).

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

Response - We suggest that final capital charge could be determined on a weighted average basis i.e. say 50% of the capital charge calculated under proposed approach and 50% on the basis of the maximum amount of actual operational losses booked by a bank in the past 3 years. This will make it more sensitive to a bank's current mix of business activities and actual operational losses incurred in the past.

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

Response - Regulator may conduct a separate QIS for their country and calibrate the coefficients accordingly.

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?

Response - Once QIS is completed, regulator should review the number of size-based buckets.

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

Response - No comments.

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

Response - We do not foresee any major challenges. However, sufficient time should be given to the banks to implement these changes. Further, specific issues relating to Islamic banking are required to be addressed.

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

Response - No comments.

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

In our view, the following element will be the most effective approach to promoting rigorous operational risk management in the banks.

1. Strict adherence to corporate governance, risk appetite frameworks and implementation of sound principles of operational risk management
2. Continuous training, awareness and sensitivity amongst the staff on the operational risk issues.

Bank # 5

Bank has no comments other than that the proposed changes reflect a prudent risk management approach. Further, the adopted approach would improve upon operational risk capital assessment methodology by including items that are sensitive to operational risk but currently omitted under Gross Income approach.

During the review of the above document it was observed that the consultative document intends to improve upon the current methodology of assessing operational risk capital under simpler approaches [Basic Indicator and Standardized Approach]. Instead of applying a set percentage on adjusted

Gross Income, the operational risk capital will be calculated using a revised Business Indicator composed of:

- Interest component
- Service component
- Financial component

The Coefficient factor [percentage] applied will be using a bucket approach i.e. percentage applied will be based on Business Indicator buckets. This approach favors smaller size banks as their Business Indicator will generally fall under lower BI buckets.

The proposed methodology removes an inherent weakness in the Gross Income approach that a fall in GI due to bank specific events / operational loss lowers capital assessed while the risks have increased.