

Comments on Basel Committee on Banking Supervision's Consultative Document
"Standardised Measurement Approach for Operational Risk"

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We, major banks in Taiwan, appreciate the opportunity to comment on the consultative document.
Our comments are as below:

Q1. What are respondent's views on the revised structure and definition of the BI?

We find there are some inconsistency between the definition of BI Component (P&L or balance sheet items) and International Financial Reporting Standards (IFRS). For example, IFRS 16 eliminates the classification of leases as either operating leases or finance leases for a lessee. Instead all leases are treated in a similar way to finance leases applying IAS 17. But the items "financial lease" and "Operating lease" remain in the definition of BI in Annex1.

We recommend aligning the definition of BI with IFRS/ IAS.

Q2. What are respondent's views on the inclusion of loss data into the SMA? Are there any modifications that the Committee should consider that would improve the methodology?

1. The SMA approach embeds greater risk sensitivity due to the inclusion of internal loss data. It also provides the incentive for banks to enhance operational risk management mechanism, improve operational risk losses, and reduce pillar 1 capital charged. We recommend that "Internal Loss Multiplier" shall not only be applied to BI bucket 2~5 but also to BI bucket 1, which might encourage banks to build up solid operational risk management mechanism.
2. Since "Grouped Losses" event might reach € 10 or € 100 million, and impact on the calculation of "Loss Component", we recommend making a clear definition to avoid arbitrage pillar 1 capital by different treatments on "Grouped Losses".
3. The explanation on "Timing Losses" is ambiguous. We recommend making a clear definition for understanding.
4. Mitigating operational risk loss through insurance is very common, especially for natural hazard damage protection. We recommend using "losses net of insurance and non-insurance recoveries" as the input for SMA loss data set, or keeping the criteria and limit on the

recognition of operational risk mitigation under current AMA. It might encourage banks to mitigate operational risk through insurance policy.

5. SMA approach is backward-looking based on incomes & expenses in past 3 years, and internal losses in past 10 years. We recommend considering forward-looking elements in the measurement. For example, the losses from a cease-of-operation business shall be excluded, or a reward discount shall be applied to loss events with significant improvements, etc.

Q3. What are respondent's views on this example of an alternative method to enhance the stability of the SMA methodology? Are there other alternatives that the Committee should consider?

After simulating the alternative method by different "m" value, we find that the "Internal Loss Multiplier" results are similar of the two methods when the $m=3$. Thus, we think the original logarithmic function shows a reasonable capital requirement and retains risk-sensitivity.