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Statement on BCBS 291

Ladies and Gentlemen, dear Colleagues,

Dealing with OpRisk matters from a managerial perspective for more than ten years, my personal comments on BCBS 291 are as follows:

1. **Developing the Regulatory Framework**
   - The initiatives of the Basel Committee to review the regulatory framework for OpRisk and to strengthen the awareness for this type of risk are very welcome.
   - This might compensate, to a certain extent, for the disadvantage that regulatory enhancements for OpRisk did not find the necessary attention within Basel III.

2. **Integrated Approach**
   - Basel II was a holistic approach,
     - covering all three risk types,
     - dealing with both the quantitative side as well as the qualitative side, and
     - distinguishing between Pillar 1, 2, and 3
   - whereas we now seem to have a patchwork approach, with BCBS 291 as one patch
     - with just OpRisk, not taking into account the linkages of OpRisk with credit and market risk
     - just dealing with the “simpler approaches” BIA and TSA
     - just dedicating to the Quant side.

3. **Importance of Operational Risk**
   - At present economic and regulatory capital for OpRisk represents about 10 % of a financial institution (or even less).
   - Thus the members of a Risk Committee of a Supervisory Board, for instance, will perhaps not devote too many resources to this risk type.
   - This doesn´t seem to be in line with the huge number and single amounts of OpLosses (not only resulting from the subprime crisis).
   - There is a concern that BCBS 291 might not increase the share of OpRisk capital significantly.

4. **Risk Sensitivity of the ”Simpler Approaches” in the Past / Present**
   - Not only in the first years of rolling out OpRisk Management it was hard to communicate the calculation method of BIA and TSA capital to front, middle and back office staff.
   - Highly profitable institutions can have low numbers and amounts of OpLosses, and vice versa.
   - Why is the Indicator Gross Income, whereas OpLosses stem from “people, processes, systems, and external events”?

5. **Risk Sensitivity of the ”Simpler Approaches” in the Future?**
   - From a statistical and statistician´s point of view BCBS 291 might deliver a risk sensitive “simple approach”.
   - Does this help?
     (… whom?, … why?, … the single institution?)
   - What about the stability of the data rows for the coming years?

6. Clarity by the New Indicator?

- The New indicator is still income-oriented, leaving many of the financial institution´s staff with a question mark, see above.
- Complexity rises, because of P&L components are treated differently. Interest Income and Interest Expenses are netted, whereas Commission Income and Commission Expenses are added.
- Highly NII-oriented institutions can have high numbers and amounts of OpLosses, whereas commission-oriented ones (with high commission expenses) might suffer comparatively low numbers and amounts of OpLosses.

7. Motivation of Staff and Management?

- Since the assumed new statistical risk sensitivity doesn´t seem to be understood easily (or at all) by non-statistician´s, the risk of lesser commitment of staff and management for OpRisk rises (black boxes are not motivating).
- Since the simpler approaches are directing at smaller and medium-sized institutions, this aspect is of even higher relevance.

8. Level Playing Field?

- From the bank manager´s point of view almost out of a sudden their (commission-oriented) business model might be punished by a comparatively higher charge of capital.
- Again – is there a rationale for this change?
  (except statistical analysis)

9. Bucketing

- The bucketing seems to make sense
  - o bigger institutions might have higher OpLosses due to the higher complexity of transactions and higher demands on the internal control system
  - o the rising percentages of the buckets incentivize bigger institutions to move to AMA (this does not apply in case the AMA will be skipped in future)
- Compared with today, smaller institutes, belonging to the first bucket, can expect an OpRisk capital relief. This might cause even lesser OpRisk awareness in the institution.

Aspects of the Further Procedure / Further Considerations are

- following a holistic approach, this includes
  - o waiting for the outcome of ongoing AMA discussions
  - o including BCBS 292
  - o including capital add-ons (or reliefs) coming from Pillar 2
- considering scoring systems
- re-considering the current percentages (BIA 15 %, TSA 12-15-18 %)
- performing an impact study re the share of OpLosses within Credit Losses, including simulations of different allocations to credit risk and OpRisk (e.g. 50:50)

Please do not hesitate to contact me in case of questions, or if you like to discuss.

Thank you for your time.

With kind regards,
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My background:
I was Global Head of ORM at WestLB, and the team and the business units implemented AMA full use until beginning of 2008. I was also member of FGOR, the WGOR at BaFin/Bundesbank. At present I am, besides my consultancy function, Head of the German Chapter of IOR. OpRisk supervisory topics are dealt with in yearly OpRisk Forums and semi-annual OpRisk Quant Workshops.