Association of Danish Mortgage Banks’ response to the BCBS Consultative Document on the Standardised Measurement Approach for operational risk

More measurement less management - at a higher price

The Association of Danish Mortgage Banks (Realkreditrådet) welcomes the opportunity to comment on the proposal on the Standardised Measurement Approach (SMA), replacing the current Basic Indicator (BIA), Standardised (SA) and Advanced Measurement Approaches (AMA).

We would like to raise some general concerns to be considered by the Basel Committee when finalising the new operational risk framework.

General comments

Preliminary assessments, to our knowledge, uniformly indicates that most banks would see a substantial capital increase under the proposed framework - irrespective of current approach. Analyses by our members lead to similar conclusions. Thus, the proposed SMA is not capital neutral.

While a general increase in higher capital charges for operational risk may be a valid objective, it contradicts the Basel Committee’s stated objective of not significantly increasing overall capital requirements. In addition, the current operational risk framework has not yet completed a full business cycle (including a once in a life-time period of stress in the financial markets). Therefore, a general increase in the capital charge for operational risk, in conjunction with the wide variety of other quite deliberate pieces of regulation, seems preemptive and we question whether it is proportionate.

SMA introduces banks internal loss experiences into the operational risk framework for all banks (excluding institutions with at Business Indicator below EUR 1 billion (bucket 1 institutions)). On its own, we find the proposal valid from a risk-management perspective given the strengthening of the risk-sensitivity for banks currently following the Basic Indicator Approach. However, seen as a whole, we fear that the Basel Committee intends to “replace” the risk sensitivity available through the application of the current AMA with a general (less bucket 1 institutions) requirement for including loss data in the capital requirements calcula-
tions for operational risk. We urge the Basel Committee to reconsider such trade-off for the below reasons:

First, removing the AMA option - and thereby the possibility to obtain a lower operational risk capital charge - severely dilutes the incentive for banks to constantly update and refine their operational risk management.

Second, forward looking risk management tools such as risk assessments and scenario analysis, in our view, adds a whole other dimension to the operational risk management. The decapitating of the forward looking arm of the operational risk manager, as proposed by the introduction of a single SMA model, effectively sets a (low) upper floor to the quality of the active management of operational risk.

Kind regards,

Peter Jayaswal
Association of Danish Mortgage Banks