Basel Committee
on Banking Supervision

Frequently asked questions on the Basel III standardised approach for operational risk

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The new standardised approach for operational risk: Frequently asked questions

Introduction

The Basel Committee on Banking Supervision has discussed a variety of issues related to the new standardised approach (SA) for operational risk capital, as published in the final Basel III standards in December 2017. To promote consistent global implementation of the standard, the Committee has agreed to periodically review frequently asked questions (FAQs) and publish answers along with any technical elaboration of the standards text and interpretative guidance that may be necessary.

This document presents a set of seven FAQs that relate to the new standardised approach (SA) for operational risk capital. The note also includes the reasoning for FAQ text that has been drafted on these issues.

1. Treatment of non-performing loans in the BI

Q1: Should credit obligations on non-accrued status (eg non-performing loans) be classified as interest-earning assets for purposes of the calculation of Interest, Leases, and Dividend Component of the BI?

Answer: Yes, all outstanding credit obligations in the balance sheet should be included in interest-earning assets.

<u>Relevant provision</u>: the Annex which provides the description of BI components (paragraph OPE10.2 table 2 of the consolidated framework effective as of 1 January 2022).

2. Timeline for exclusion/inclusion of losses and BI items after divestiture/deconsolidation and acquisition/merger

Q2: Upon supervisory approval to exclude losses, when should this exclusion take effect?

Answer: Such losses should be excluded from the calculation of the loss component of the operational risk capital (ORC) immediately after the supervisory approval. If supervisors only require the operational risk standardised approach calculation to be updated annually, but the exclusion is approved prior to an intermediate (eg, quarterly) update of the bank's total risk-weighted assets that precedes the annual update of the operational risk standardised approach, banks should report the revised operational risk risk-weighted assets in the first update of total risk-weighted assets post-exclusion.

<u>Relevant provision</u>: paragraph 27 of the framework (OPE25.30 of the consolidated framework effective as of 1 January 2022).

Q3: Upon supervisory approval to exclude activities from the BI, when should this exclusion take effect?

Answer: Such activities should be excluded from the calculation of the BI amount used for the calculation of operational risk capital (ORC) immediately after the supervisory approval. If supervisors only require the operational risk standardised approach calculation to be updated annually, but the exclusion is approved prior to an intermediate (eg, quarterly) update of the bank's total risk-weighted assets that precedes the annual update of the operational risk standardised approach, banks should report the revised operational risk risk-weighted assets in the first update of total risk-weighted assets post-exclusion.

Relevant provision: paragraph 30 of the framework (OPE25.33 of the consolidated framework effective as of 1 January 2022).

Q4: Upon a merger or an acquisition, when should the inclusion of the losses and BI items of the merged entity or acquired businesses take effect?

Answer: Losses and BI items from merged entities or acquired businesses should be included in the calculation of operational risk capital (ORC) immediately after the merger/acquisition, and should be reported in the first update of the bank's total risk-weighted assets that comes after the merger/acquisition.

Relevant provision: paragraph 31 of the framework (OPE25.34 of the consolidated framework effective as of 1 January 2022).

3. Conversion of losses from foreign subsidiaries into local currency

Q5: When building the loss data set, which exchange rate should be used to convert losses from foreign subsidiaries of a banking organisation into domestic currency?

Answer: Loss impacts denominated in a foreign currency should be converted using the same exchange rate that is used to convert them in the banking organisation's financial statements of the period the loss impacts were accounted for.

Relevant provision: paragraph 21 of the framework (OPE25.18 of the consolidated framework effective as of 1 January 2022).

4. Treatment of refunds due to overbilling

Q6: When a bank refunds a client that was overbilled due to an operational failure, can the initial overbilling be used to net out the refund?

Answer: If the refund is provided in the same financial accounting period as the overbilling took place and thus no misrepresentation of the institution's financial statements occurs, there is no operational loss. If the refund occurs in a subsequent financial accounting period to the overbilling, it is a timing loss; any operational loss event that exceeds the threshold of EUR 20,000 (or EUR 100,000 if the national supervisor has used the national discretion to set this higher threshold) should be included in the loss dataset. In this case, the prior overbilling is not a recovery.

Relevant provision: paragraph 23.e) of the framework (OPE25.26(5)) of the consolidated framework effective as of 1 January 2022).

5. Treatment of losses from outsourced activities

Q7: Should operational loss events from outsourced activities be included in the operational loss dataset?

Answer: The financial impacts of events that the bank is responsible for should be included in the dataset as operational losses. The financial impacts of events that are paid by the outsourcer (rather than by the bank) are not operational losses to the bank.

Relevant provision: paragraph 19.d) of the framework (OPE25.18 of the consolidated framework effective as of 1 January 2022).