

ZENTRALER KREDITAUSSCHUSS

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31 March 2010

Consultation paper on the management of operational risks in market-related activities (CP35)

Dear Sir or Madam,

On 21 December 2009, the CEBS published a consultation paper entitled “Management of operational risks in market-related activities”. We have pleasure in taking this opportunity to express our views.

General observations

We can empathise with the efforts made by the CEBS to subject the operational risk of market-related activities to special control, especially against the backdrop of the rogue trading event discovered at SocGen, to which the paper refers.

The concept of market-related activities is deliberately left open in the consultation paper (e.g. paragraph 7). However, greater clarification in respect of market-related activities – possibly in connection with specific products or transactions – would be helpful for the practical implementation of the principles.

We welcome the formalisation of the principle of proportionality (paragraph 8).

Up to now still some ambiguity exists regarding the legal basis of these guidelines (article 122 CRD?). However, aspects of CP35 (e.g. voice recording) relate to individual regulation of MiFID, which fall within the competence of host regulators. That leaves room for interpretation. It is urgent to clarify the legal basis and the competent authority (ideally home regulator).

In our opinion, it should be clarified that the date of 31 December 2010, referred to in paragraph 9, is the target deadline for transposition in the respective national legislation and not for the implementation of the new rules in the respective banks. We consider 30 June 2011 to be an appropriate date for the latter implementation.

Detailed observations

Principle 1

With reference to the high-level principles for risk management, we assume that overall responsibility for the organisational structure, the development of the internal control system and the reporting system lies with the management body. The identification, assessment, control and monitoring of operational risks, on the other hand, are undertaken by subordinate bodies or committees.

Principle 2, paragraph 15

Although staff movements between front, middle and back-office may entail a certain risk potential, especially within a trading product category, we consider that labour law aspects already render the requirement of “close monitoring” problematic. We request the deletion of the word “close”. Furthermore, the paper gives no indication of how such monitoring should be organised. Examples would be helpful here.

Principle 4, paragraphs 20 and 21

Overall, given the broader definitions, the many causes of operational risks from market-related activities and frequently only inadequate quantification of these risks, defining a maximum acceptable level of risk tolerance for operational risks which is possibly even to be reflected in the remuneration appears as a major challenge.

Paragraph 21 mentions agreeing maximum acceptable levels of operational risk exposure as targets for business managers and traders, as a conceivable measure to ensure the appropriate balance between profitability drivers and operational risk culture. In our opinion, the acceptable level of operational risk is not necessarily defined in quantitative terms, e.g. in the form of capital or value-at-risk, but may also be subject to a qualitative assessment. Alternatively, the institutes should be allowed to set targets and objectives relating to the

use of appropriate control mechanisms. Furthermore, in terms of the proportionality principle, in cases where an institution offers remuneration with only a very low variable component, direct participation in the operational risk losses will not be necessary at all.

Independent of our critic in detail, we would like to point out altogether, that the person in charge of operational risk is generally depending of the voluntary announcement of loss events. In this regard, on behalf of the disclosure of operational risk, a lot of institutes strive towards an adequate incentive structure. By the compulsive consideration in the remuneration, false incentives could possibly be set, which would be contrary to the management of operational risk.

Principle 5

Under Principle 5, the institution must be in a position to detect fraudulent activities in good time.

For the understanding of how fraud can occur, we support fully the benefits of using scenarios according paragraph 23. In fact, there are many ways of fraud detection. Scenarios are just one example. We recommend to delete paragraph 23 and to insert the content as example in paragraph 24.

The examples of fraud prevention set out in paragraphs 24-26, against the backdrop of the principle of proportionality, should not necessarily have to be applied by all institutions. In particular, institutions which apply the basic indicator and standardised approaches in respect of capital requirements and which also do not carry out any significant trading activities should be able to refrain from individual measures and definition of risk tolerance.

In principle, we agree the suggestion in point 4 of paragraph 24 to use alerts/warning systems to monitor fraudulent activities. In practice, however, the introduction of such a system can cause different challenges. For this reason we suggest to replace the last sentence as follows: "... to permit the management to identify any fraudulent activities in an appropriate time and react in this way."

Principle 6, paragraph 31

A special topic within the MiFID work of the European Commission is demands on tape recordings. In order to avoid overlaps we recommend to await the final result of this revision as well as the appropriate MiFID introduction. Furthermore we notice that in some EEA countries data protection legislation works which make an overall recording more difficult.

Principle 10, paragraph 39

According to the first sentence, a review of the relations between market counterparties and front office staff is to be undertaken regularly. We should appreciate clarification of what is meant by the review. This could conceivably refer, for example, to compliance with the code of conduct within the meaning of paragraph 14. Instead of the term “market counterparties” that is not yet defined, we would recommend the term “professional clients and eligible counterparties”. In addition, the question arises what is meant by “commercial issues” and why these are to be taken up by the control functions.

Principle 11, paragraphs 41, 45, 46 and 49

The reliable process for confirmation required in the first sentence of paragraph 41 should be supplemented to the effect that in the case of trades which are cleared via a settlement system ensuring an automatic reconciliation of the closing dates (confirmation matching systems), the confirmation process can be waived. The same should apply in cases where the settlement system of the two parties to the transaction allows consultation of the closing dates at any time. A separate confirmation or acknowledgement could only lead to further transfer errors (e.g. operational risks).

Paragraphs 45 and 46 set out the requirements for the handling of nostro accounts. However, in our estimation the requirements do not directly concern the identification and monitoring of operational risks but rather the organisational processes of trades. In this respect, we advocate the cancellation of both paragraphs.

Paragraph 49 sets out the various requirements for the settlement of OTC transactions. With a view to the regulatory initiatives to settle OTC derivatives in future via a central counterparty (CCP), we consider it necessary for the CCP also to satisfy the requirements of the confirmation, settlement and reconciliation processes. In cases where formerly OTC products were settled via a CCP, individual requirements of Principle 11 would not be applicable for the institutions. As we understand it, this would also be the case for certain requirements of Principle 12 (e.g. paragraph 52). We request additional clarification.

Principles 11 to 14

Several principles of the consultation paper call for monitoring and control of market-related activities on a real-time basis. This is to cover the consideration of the nostro accounts of a bank, the calculation of credit lines and net positions and the monitoring of the trade limits. Institutions which engage in trades only to a manageable extent are often not technically equipped with the real-time trading/settlement systems necessary for this purpose. A subsequent upgrade of the technical systems would give rise to considerable costs

and be totally disproportionate to the alleged operational risk. Since, as we understand it, the real-time basis requirement is essentially a time criterion, we assume that the requirement could also be implemented without technical support. We request clarification on this subject.

Principle 14, paragraph 59

The third sentence requires computation limits to be updated without delay so that controllers can monitor compliance with the limits. We request clarification on whether the job of the controller comprises the control functions referred to in paragraph 12. If so, we ask that the controller also be mentioned in paragraph 12.

We also recommend a clearer description and definition of terms “net amounts” and “gross notional amounts”.

For further questions we are always prepared to support you with detailed information.

Yours faithfully,

On behalf of

ZENTRALER KREDITAUSSCHUSS



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