



Keynote address: OpRisk Europe 2005

José María Roldán | 16 March 2005

CEBS

Committee of European
Banking Supervisors

Outline

- **Introduction**
 - The Committee of European Banking Supervisors
- **Basel II and OpRisk**
- **Regulatory treatment of OpRisk**
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 - Standardised Approach
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- **Model validation**
- **Internal governance**
- **Role of supervisors**

CEBS

CEBS is a committee of high level representatives from the banking supervisory authorities and central banks of the European Union, including the European Central Bank
25 countries and 46 member organisations, observers from EEA* countries, the European Commission and the Banking Supervision Committee of ESCB (European System for Central Banks)

Chairman - José María Roldán

Vice Chair - Danièle Nouy

Secretary General - Andrea Enria

* Iceland, Liechtenstein and Norway

Tasks of CEBS

- to advise the European Commission on banking policy issues, in particular for the preparation of draft measures for the implementation of European legislation
- to foster a common day to day implementation and application of Community legislation by issuing guidelines, recommendations and standards
- to promote supervisory co-operation and provide for the exchange of supervisory information

Work Programme 2005

Priority areas of work

Regulatory advice to the Commission

Cross-border mergers in banking
The definition of regulatory capital
Supervision of liquidity risk

Convergence of supervisory practice

Supervisory review process
Validation of IRB and AMA systems
External Credit Assessment Institutions (ECAIs)
Common reporting
Supervisory disclosure
Development of IFRS compliant formats
Supervisory guidance for the new IFRS framework

Co-operation and information exchange

Home/host issues
Crisis management
Information exchange

Other areas of work

Risks to banking stability
Outsourcing
Internal governance
Impact of IFRS on prudential requirements.
The role of the audit function for prudential supervision.
The behavioural impact of the IFRS on banks.

Cross-sectoral issues:

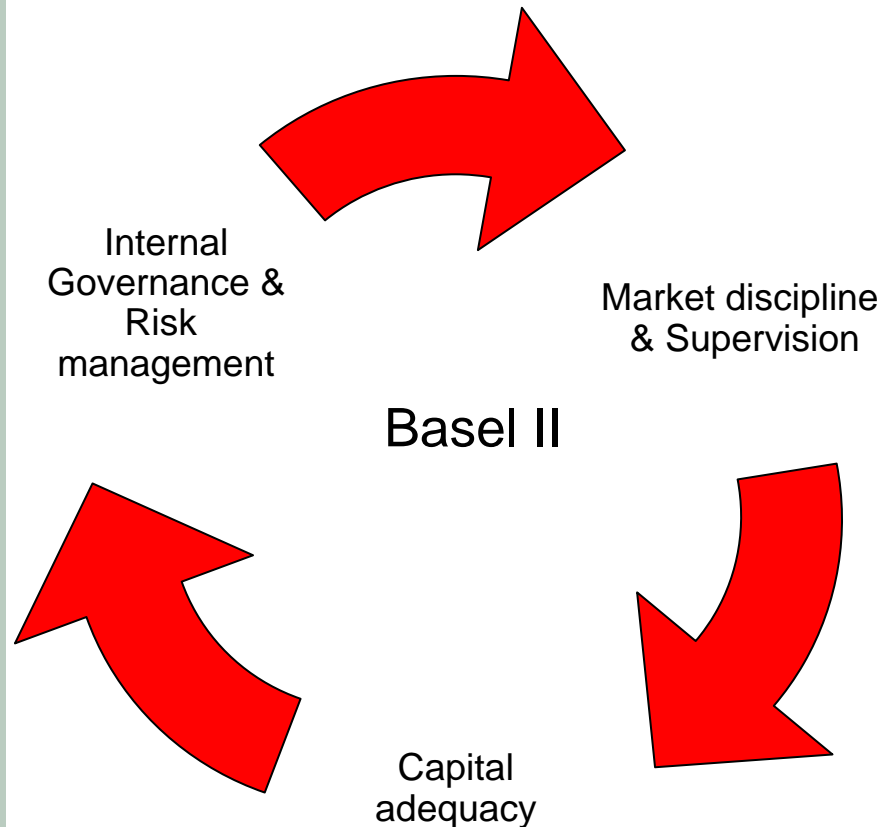
Conglomerates

Delivered products

CP supervisory review
CP Common reporting
CP Outsourcing
Advice National discretions (work continues 2005)
Advice Prudential filters

Basel II and OpRisk

- Basel II is more than capital adequacy
- Capital requirements aligned with actual risks
- Incentives for better risk management
- More transparency \Rightarrow market discipline
- Dialogue with the supervisors
- Financial stability



Basel II and OpRisk

- Forward looking approach
- Basel II has had an effect already – banks are improving their systems and policies
- Quantitative and qualitative assessment of risks – human judgement
- Integrated and centralised risk management
- Supervision of cross-border groups (home-host)
- Validation of risk models

Regulatory treatment of OpRisk

- Capital Requirements Directive (CRD)
 - A window of opportunity in promoting consistency in banking regulations and convergence in supervisory practices
 - Group-wide measurement and management of risk, with supervisory responsibilities allocated according to the residence of legal entities \Rightarrow CEBS' work on convergence of supervisory practices and on co-operation between home and host supervisors
- Three different approaches to OpRisk:
 - Basic Indicator Approach
 - Standardised Approach (SA)
 - with the sub-case of the Alternative Standardised Approach
 - Advanced Measurement Approach (AMA)

Regulatory treatment of OpRisk

- **Basic Indicator Approach**
- Regulatory capital is 15% x “the relevant indicator” (average over three years of the sum of net interest income and net non-interest income of the whole bank)

Regulatory treatment of OpRisk

- Standardised Approach (SA)

- Division of the bank's business into eight different "business lines" (e.g. Corporate Finance, Trading and Sales or Retail Banking), each with a different multiplier for the relevant indicator (e.g. 18% for corporate finance and trading and sales, 12% for retail banking)
- Regulatory capital is the simple sum of the regulatory capital of each of the eight business lines)
- For the Alternative Standardized approach a different relevant indicator for the retail and commercial banking can be used:
 - A normalised income indicator equal to the three-year average of the total nominal amount of loans and advances multiplied by 0.035
 - Can only be applied under certain conditions

Regulatory treatment of OpRisk

- Advanced Measurement Approach (AMA)
 - Capital requirements can be calculated with the help of internal operational risk models (e.g. as the 99.9% Quantile of a loss distribution)
 - Use for regulatory purposes only when general risk management in Article 22 and Annex V as well as the qualifying criteria in Annex X Part 3 are fulfilled (both qualitative – internal governance - and quantitative standards)
 - Quantitative standards
 - Process for estimating and validating the “Operational value at risk” (Para 8 to 12 of Annex X, Part 3)
 - Minimum requirements for use of internal data (Para 13 to 18)
 - Minimum requirements for use of external data (Para 19)
 - Use of scenario analysis (Para 20)

Model validation

- New framework relies to a large extent on internal measures of credit risk (Internal Ratings-Based Approach - IRB) and operational risk (Advanced Measurement Approach - AMA)
- Supervisors have to review the methodologies used for estimating risk parameters and grant permission for the use of these approaches for regulatory purposes.
- CEBS is developing quantitative and qualitative requirements for discrimination and calibration of rating systems, estimates of PDs, LGDs, EADs and AMA parameters.
- Minimum standards for the review of the methodologies applied by credit institutions and investment firms
- Consultation in July 2005

Internal governance

- Included in the Supervisory Review Process (Pillar 2)
- The board of directors awareness of the major aspects of operational risks
- Approval and review of operational risk management framework, which provides clear definition of operational risk and lays down the principles of how operational risk is to be identified, assessed, monitored and controlled/mitigated
- Operational risk management framework subjected to effective and comprehensive internal audit
- Senior management responsible for implementation of operational risk framework and developing policies, processes and procedures for managing operational risk

Internal governance

- Identification and assessment of the operational risk inherent in all material products, activities, processes and systems
- Regular monitoring of operational risk profiles and material exposures to losses, proactive risk management
- Policies, processes and procedures to control and/or mitigate material operational risks
- Contingency and continuity plans

Role of supervisors

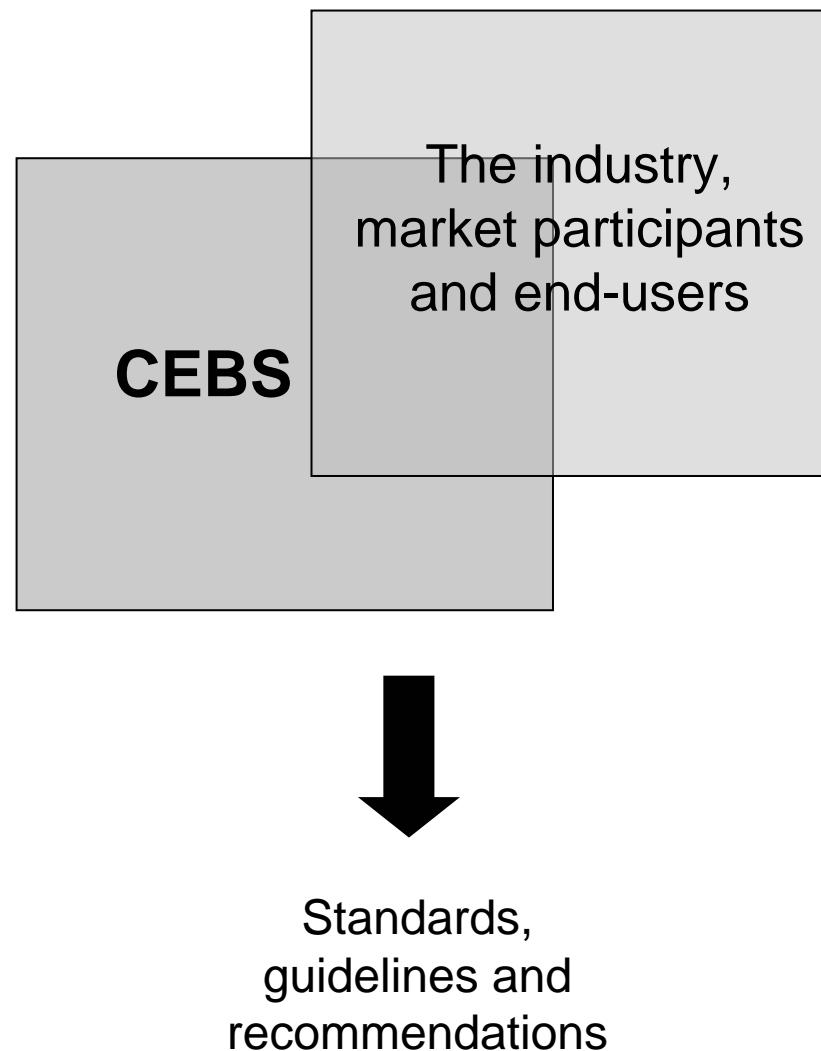
- Supervisors require that banks have an effective framework in place to identify, assess, monitor and control/mitigate material operational risks
- Supervisors conduct regular independent evaluation of bank's policies, procedures and practises related to operational risks
- Appropriate mechanisms in place to allow supervisors to remain apprised of developments at banks

...and public disclosure:

- Banks should make sufficient public disclosure to allow market participants to assess their approach to operational risk management

CEBS and consultation

- Consultation with the industry, market participants and end-users
- Objectives: transparency, benefit from expertise of market participants and end-users, dialogue and interaction
- Tools: public consultation on CEBS products, hearings, panel
- Consultative Panel composed of 19 members with main task of acting as a sounding board in strategic issues





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