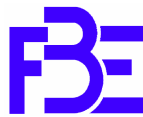

Enclosure 1 to Letter n° 0112
O6010FEO

Fédération Bancaire Européenne
European Banking Federation

FBE RESPONSE TO CEBS' CONSULTATION CP10 (Revised)

Guidelines on the implementation, validation and assessment of Advanced Measurement (AMA) and Internal Ratings Based (IRB) Approaches

Introductory comments

1. The FBE welcomes the opportunity to comment on the revised guidelines on validation of the advanced models. As we have stated in our covering letter to this paper, the short deadline for response to the consultation makes it difficult for industry to respond in detail to the guidelines. We feel that, for this reason, it is essential to have a public hearing to highlight the key issues. Our response to CP10(R) will focus on the new sections which have been included in the revised paper. However we have also commented on unrevised parts where we continue to feel that CEBS should make changes as a priority.

2. As stated in the first consultation, the FBE believes that CP10 comes too late to address the issue of inconsistency between application packs. We believe that CP10 will result in greater burdens on the industry, and on supervisors, at a time when resources are stretched. Furthermore, it is unclear what impact the lack of preliminary application in certain member states due to national legislation will have on the joint application process. The FBE would like clarification on what exactly happens if a host supervisor does not accept a preliminary application as part of the home supervisors approach. We would also like clarification on the application process for partial use. It is our view that only one file should be submitted for the whole institution, including a description of all methods to be used. There should not be additional application files in host countries for those subsidiaries within the group that will adopt a more basic approach.

3. The FBE welcomes the goodwill clause in paragraph 8a and 14a and the flexibility which it allows for institutions which have already completed their preliminary applications. However, some of our members are concerned about the possible level playing field implications of different interpretations of the clause.

4. The FBE is also concerned that paragraph 14a only refers to sections 3 and 4 and not to section 2. It is not clear to us why this is the case. Banks which are already far advanced in their implementation work will be required to do considerable work to comply with Section 2 of the guidelines. We would encourage CEBS to extend the goodwill clause across the entirety of the guidelines.

5. Furthermore, recognising the scope and mandate of CEBS and of its guidelines which are stated in paragraph 15, the FBE would encourage CEBS to continue to frame its work in the international context in which many EU firms are operating. Validation of the advanced models on a global basis will be further complicated by different timelines and approaches across jurisdictions.

6. While we appreciate that CEBS has incorporated more flexibility into parts of the paper, we continue to have reservations about the objective of CP10, the level of detail included in it and the process which has been used to arrive at certain parts of the guidance.

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7. As stated previously, the FBE supports **a top-down, principles based approach to validation**. We feel that in CP03 CEBS was successful in identifying the right level of detail needed to deliver an appropriate degree of supervisory convergence. High levels of detail are not necessary to achieve convergence. What is needed is a commonality of approach and a shared culture in assessing the way banks manage risk and develop their systems. In the view of the FBE the CP10 guidelines do not meet that standard. In fact, the FBE notes that the revised paper incorporates more detail than the original version. This overprescriptive approach could result in regulatory guidelines determining the risk management practices of banks. CP10 should not under any circumstances be treated like a handbook for supervisors. This would stifle innovation in the industry and would downgrade the importance of bilateral dialogue between individual institutions and their supervisors. It would lead to a check list approach by some regulators which would create an unlevel playing field.

8. One example of the danger of a high level of detail in CP10 relates to documentation and self-assessment requirements. The combination of documentation requirements arising from the "use test", and those related to the obligation of banks to demonstrate to their supervisors that they meet minimum requirements at the outset and on an ongoing basis, poses many challenges for banks. There is, therefore, a risk that the "general" request for documentation in paragraph 277 and the description of self-assessment in paragraph 64 could easily become a voluminous, paragraph by paragraph, self-assessment process, which does not differentiate between mission-critical elements and less-central aspects.

9. The FBE believes that the formal application should actually be construed as a summary of the bank's internal methods together with the precise identification of the exposures concerned. It cannot be the basis for a full validation exercise, which requires in-depth analysis and extensive documentation which is only made available in the course of on-site examination. The FBE continues to believe that the formal application should be supplemented by a "qualification certificate" issued by the relevant supervisor, in most cases the home supervisor, and guaranteeing that the said internal methods are compliant in order to foster an efficient circulation of information amongst supervisors. This would encourage better coordination and would be the best use of supervisory resources.

10. The CP10(R) text on operational risk guidelines does not always reflect industry practice or risk management realities. We assume that the ideas in the text rely on academic theory as a basis and/or anecdotal evidence. This is particularly evident in the new sections relating to the more technical aspects of validation of the Advanced Measurement Approach (AMA). This issue feeds into the FBE's concern about the process used within CEBS to develop these guidelines.

11. A significant concern in this regard relates to the introduction of new terminology into the guidelines which is neither defined nor commonly used within operational risk practice. We would stress that we do not encourage CEBS to produce taxonomy of definitions, especially at this late stage in the implementation process without an intense dialogue with industry to better understand current common and leading operational risk practices on which it guidance in this area should be based.

12. In particular, the approach to correlation in the guidelines on operational risk contradicts the empirical experience, industry practice and the supervisory approaches to other risk classes, particularly those currently endorsed for Market Risk or those embedded in the regulatory prescribed IRB approaches. The proposed CEBS requirements are going far beyond the Directive and the overly

conservative standards (illustrated by a correlation higher than 1) jeopardises the consistency between the supervisory requirements and the banks' risk management practices and compromises strongly the incentive to move to AMA., Therefore, those standards are unacceptable

13. The FBE is also concerned that the level of detail in the operational risk aspects of the paper is unhelpful and not in line with a principles based approach. The prescriptive approach in the guidelines and many of the individual requirements do not reflect the developing nature of operational risk management and the evolution in the understanding of the risks themselves, both within industry and the supervisory community.

14. It is our analysis that the operational risk sections of the guidelines encourage, if not introduce, superequivalence to the CRD. In the feedback document, CEBS states that its task is to explain and clarify the provisions of the CRD. However, the draft guidelines as they currently stand go far beyond explanation and clarification. The FBE would argue that CP10 in fact expands the CRD significantly. While CEBS cannot prevent its members introducing superequivalence at a national level, it should encourage them not to. CEBS should also not, under any circumstances, introduce superequivalence itself through its guidelines as an initiative to promote convergence and consistency.

15. In the interests of promoting convergence and leading practice, the FBE would encourage CEBS to organise a survey of firms and publication of leading practice used. Such a publication would also provide an opportunity for the regulators to identify aspects that could benefit from further exploration by firms and academics. We would also urge CEBS to recognise that the adoption of leading practice within firms is aligned with proportionality and the scientific environment of firms.

16. In addition to the specific concern relating to the terminology used in the operational risk section of the paper, the FBE feels that there is a general problem with the inconsistent use of terminology throughout CP10. Appreciating the time constraints and the fact that CP10 has been drafted by a number of different sub-groups within CEBS, the FBE feels that it is of utmost importance that the language be reviewed and that the appropriate terms be used in each section. For example, there are significant differences in interpretation between the "risk measurement system", "risk measurement framework", "risk measurement methodology" etc. Furthermore, the same wording is used in parts for both the Internal Ratings Based Approach (IRB) and AMA ignoring their distinctive characteristics.

17. We remain concerned that, where examples are given in the paper, that these could, through interpretation, develop into supervisory guidelines which would then be used by auditors and others in evaluating banks' systems. We appreciate that CEBS has gone some way towards addressing this concern. However, it seems that this exercise, while clarifying some of the language, did not tackle the substantive issue of providing examples which could be interpreted as guidelines.

18. While the FBE accepts that Member States are entitled to gold-plate both the Directive and CEBS guidelines, the strong language used in paragraph 23a is directly contrary to the spirit of supervisory convergence which is of utmost importance in the EU. CEBS should make clear in its guidelines that Member States should seek to limit superequivalence to areas deemed necessary due to local market conditions. Any additional guidance should be fully justified and disclosed so that industry can fully understand where the differences lie and the reasoning behind them. In addition, inconsistencies in supervisory approaches

should be addressed by CEBS and reduced over time in order to deliver supervisory convergence.

19. In Paragraph 14b it is clear that the guidelines should evolve over time in line with developments in the financial services industry. However, the wording of this section is left open which raises concerns for banks wishing to innovate. We encourage CEBS to ensure that there are sufficient transitional periods to allow the financial industry to comply with the evolving regulatory requirements efficiently.

20. Banks are concerned with the burden and cost of translation that paragraph 67 could pose. Policies, internal models processes and systems are numerous. Full documentation in multiple languages would be unjustifiably burdensome. We recommend that no more than two languages may be requested for the most basic documents and that only the operational language be used for the more technical processes and their related documentation procedures.

21. Paragraph 74 states that supervisors can carry out validation methods conducted by internal or external staff. There is a danger of conflicts of interest arising where consultancy firms are used for these purposes. It could furthermore jeopardise the proprietary information of the firm. CEBS should make clear that third parties should only be used where it has been established by the supervisor that no conflict of interest could occur.

Detailed comments

3.3.1.1.2 Qualifying revolving retail exposures

22. 168: The unaltered, connected requirement to measure loss volatility for all three retail classes poses an unacceptable burden and implies a high iterative workload.

3.3.1.3 Securitisation exposure class

23. The FBE believes that CEBS has again provided guidelines which are too detailed and too prescriptive in this rapidly developing area. We believe that this is a section of the guidelines where supervisors need high level principles to guide their analysis of risk management through securitisation. However, the level of detail currently included will only serve to limit innovation in the securitisation market. In addition, the FBE believes that detailed guidelines in this area could result in a box ticking or auditing type approach which would not encourage supervisors to understand the complexities of the instruments used and developed by market participants. This would introduce a prudential danger into the supervision of securitisation. We would further question whether this approach would not place an unnecessary burden on supervisory authorities in terms of whether the appropriate level of skilled resources are available to undertake such detailed reviews. We believe that supervisors should only want, or need, to look at those transactions where there might be some doubt as to the significance of risk transfer. This approach, combined with dialogue under Pillar 2 should provide supervisors with sufficient comfort.

24. With respect to Significant Risk Transfer (SRT), CEBS introduces a number of issues, such as the references to accounting practice, that fail to provide the clarity and guidance needed. CEBS' proposed guidelines in this regard 'quantitative thresholds based on the percentage of losses retained by the originator as a first loss tranche) may not be consistency with a regulatory framework that applies capital floors to senior exposures and would likely result in many securitisation transactions not benefiting from regulatory capital relief. Furthermore we note that

contrary to prior industry comments CEBS has elected to provide granularity and prescriptiveness through the inclusion of examples. The FBE does not support the use of examples in this context, in particular where they introduce further ambiguity.

25. Taking the above comments into account, the FBE would support a rewriting of this section of the guidelines.

26. 187a: The final sentence of this paragraph should also make reference to the Internal Assessment Approach.

27. 187c: To clarify the point made in brackets at the end of sub-paragraph c), we propose that the last clause should read: *"…, default in respect of individual tranches might occur at different points in time over the lifetime of the transaction."*

28. Concerning boundary issues with specialised lending, paragraph 187d refers to Annex III in cases of uncertainty. For consistency with the text of the CRD, we would propose that the words "direct control over the physical collateral" in Annex III (4) should be changed to "substantial degree of control".

29. 187f: It is intended to clarify that an originator who fails to transfer significant credit risk has to "keep the securitised exposures under the retail and corporate exposure class". This is misleadingly since in principle exposures from every exposure class can be securitised. The FBE suggests instead that the originator should have to calculate risk-weighted exposure amounts for the securitised assets according to the rules for the "respective exposure class".

30. 187h-187k: We propose CEBS delete the last two sentences of 187h, all of 187i and 187j, and the beginning of 187k up to '…accounting derecognition'. We do not consider that the addition of this guidance is helpful and we consider that the only guidance necessary is to state that accounting derecognition is neither a prerequisite for, nor evidence of, significant risk transfer. While we appreciate that CEBS' intention is to provide helpful guidance, there is concern over the references to accounting rules in the guidelines which are likely to result in risk measurement being inappropriately influenced by an accounting treatment that may not necessarily reflect the economic reality.

31. 187l and 187m: As outlined above, we do not believe that the quantitative assessment in these paragraphs addresses the issue of transactions where no risk has been transferred from the originator, which we understand to be the purpose of the significant risk transfer requirement. Furthermore, we consider that the process envisaged with respect to the determination of significant risk transfer is not risk sensitive and would require a significant amount of regulatory resource. Paragraphs 187l and 187m seem to require supervisors to assess the amount of risk transfer in each transaction at inception and on an ongoing basis. In addition, the assessment of whether the risk transferred is significant must be consistent with a regulatory framework that applies floor levels of capital to senior exposures. We do not consider that the guidance has captured this - for example, the designation of transfer of "tail end" or "catastrophic" risk (achieved by the sale of AAA rated tranches alone) as 'significant' should be incontrovertible.

32. We consider that it would be helpful to include guidance to the effect that where originators do not wish to obtain a regulatory benefit or where they do not meet the requirements for significant risk transfer, that they do not need to meet the other requirements regarding securitisation.

3.3.1.4 Equity exposure class

33. The inclusion of indirect equity exposures, i.e. "holdings in corporations, partnerships, limited liability companies or other types of enterprise which issue ownership interests and are engaged principally in the business of investing in instruments" is unclear. This poses problems particularly under an individual entity-level approach. If, for example, holdings in "financial enterprises" (Art. 4 no. 5 of Directive 2000/12/EC) are not deducted from equity, the holdings of the financial enterprise would have to be treated by the bank in the IRBA within the framework of a "look-through" approach. We reject this, as the bank's loss is limited to the amount invested in the financial enterprise. The "look-through approach" would, moreover, constitute an additional "partial consolidation" that is not offset in supervisory terms by any gain in knowledge going beyond group reports.

34. 187s-187x: The proposed guidelines should not diverge from the CRD definition of equity exposure as given in CRD Article 86. Rather firms should be asked to introduce transparent and auditable internal processes and criteria for the classification of debt and equity products. This is important to retain flexibility regarding the treatment of products in accordance with market development. In particular products with debt- and equity-characteristics (e.g. Mezzanine) are an important and dynamic market segment. Therefore regulatory rules for the categorization of these products need to provide sufficient flexibility to keep up with innovation in the market. Market judgement regarding these products takes several dimensions into account to determine the classification (see for example "Moody's Toolkit: A Framework for Assessing Hybrid Securities", Dec 1999, which analysis products along the dimensions "maturity", "loss absorption" and "No ongoing Payments" to place these on the "debt-equity continuum") and is not static. The proposed mostly one-dimensional provisions are not suitable for this purpose and might interfere with market developments (e.g. missing maturity - 187u (1)).

35. 187u: At first glance, all instruments with the same structure as an instrument accepted by banks as Tier 1 capital are to be included as equity exposures. We would like to point out in this connection that the term "Tier 1 capital" does not appear in Directive 2000/12/EC. Reference should be made instead to the capital components in Article 57 a)-c) of Directive 2000/12/EC.

36. 187u continued: Regarding deferral of settlement as a criterion for equity exposure, in paragraph 187u (1), the fact that the issuer may defer indefinitely the settlement of the obligation should not automatically classify a product as equity. Classification should be based on a broader analysis of the instrument and not on single features. In this case, for example, step-up clauses can make repayment nearly certain, even if the issuer legally has the right to defer repayment.

37. 187x: We reject CEBS's proposal to automatically assign convertible bonds to the equity segment. Since the conversion of the bond into shares / equity is only an option, the exposure should be treated as any bond, as long as the option is not exercised. Only after conversion of the bond into shares would the exposure be assigned to the equity segment.

38. 188 and 188c: CEBS should not introduce additional criteria regarding the choice of approaches by the institution for the calculation of risk-weighted exposure amounts for equity exposures. These criteria are not part of the Pillar I requirements in the CRD and could therefore narrow the leeway given by the Directive, especially with respect to the Simple Risk Weight Approach. The criteria are described adequately in Annex VII, Part 1(15) of the CRD.

39. 188c: The requirement to integrate the regulatory models into the risk management process is too prescriptive and unrealistic as banks will prefer, and must be allowed, to employ their own internal models to manage risks.

40. 188d: CEBS should not refer to active portfolio-management as a criterion for sufficiently diversified portfolios. Sufficient diversification and active portfolio-management are different criteria. The CRD only refers to sufficient diversification and CP10R should not introduce a new, additional criterion.

3.3.1.5 Purchased Receivables

41. The FBE welcomes the clarity which has been brought to the treatment of purchased receivables and in particular factoring/invoice discounting type transactions. In particular we support the clear and concise description of the relationships in this industry summed up in paragraphs 188j-k. We believe the potential three treatments outlined in paragraph 188j provide flexibility which should accommodate the requirements of the invoice finance industry across Europe. Overall, we are pleased that the supervisors have gained a deeper understanding into invoice finance and do allow for flexibility.

42. Industry particularly welcomes inclusion of option one, which treats the seller as obligor. Under this approach, in treating as an exposure on the seller, we assume that the "eligibility" of the receivables as collateral only applies in the Standardised and Foundation IRB approaches. It is our understanding that the concept of eligible financial collateral and eligible guarantors is applicable only under these approaches, it affecting the supervisory values of LGD and/or adjusting the effective value of exposures (the so-called E* measure). Own estimates of LGD under Advanced IRB are at the discretion of the financial institution, subject to supervisory approval, and are not subject to "eligibility" requirements.

43. Option three allows for the invoice financier to develop Expected Loss via a pooled methodology in the absence of granular data on the obligor (debtors). Although theoretically appealing, this option may prove challenging. It would be particularly difficult where invoice finance providers currently look at their exposures from the perspective of the seller, considering the likelihood of default and the losses anticipated on default (PD & LGD)., Option 3 appears to ignore the role of the seller in the invoice finance relationship, focusing instead on the obligors alone and their likelihood to repay debts on default. In the UK this would create a disconnect between current industry practice and the proposed treatment. We do not support prescription on the use of this approach as it would require a rethink of existing business practices, and the risk of double counting risk from the seller-perspective and the obligor-perspective is high.

44. 188t: The text remains unclear regarding the seller's default and its link with dilution risk. 188t states that dilution risk refers to the possibility that the potential amount of receivables bought and financed by the institution may be reduced on the initiative of the seller. Regarding the examples which are given, ("offsets or allowances rising from return of goods sold, disputes regarding product quality, possible debts of the borrower to a receivables obligor and any payment or promotional discounts offered."), it is important to note that these losses only materialise when the seller is in default. In most cases, when the seller is not in default, recourse exists and the difference between what is due to the bank and what has been received by the institution must be paid back.

45. 188u: The proposed pro rata treatment of dilution is overly prescriptive and not reflective of the way dilution risk is addresses in ABCP transactions. We recommend this paragraph be deleted.

46. 188x: Dilution risk is commonly reflected in the price. The prescribed CRD EL (i.e. PD*LGD) is an unsuitable measure to assess materiality, as it already assumes that the risk is material.

3.3.2.1 Definition of default

47. *[195: The definition of default implicitly involves some scope for subjective judgement in the traditional concept (the customer's "unlikeliness to pay"). Regarding the definition of "past due", the use of purely quantitative criteria, such as the threshold of materiality, has shortcomings (what if a loan goes above the materiality threshold for just one day during the 90/180-day observation period?).]*

48. 196: In some situations, if a materiality threshold set at national level is used there are a significant number of positions that return to performing status. The FBE seeks clarification on whether it is correct to apply an interpretation whereby the bank can use, in calculating its "past due" positions for calibrating PD, a different materiality threshold which factors in an analysis of this "cure rate".

3.3.2.2 Definition of loss

49. 198-199: The definitions of realised loss and loss in LGD are unclear and potentially ambiguous. A table of comparison between CRD and IAS to solve definitional problems and those connected with the actualization rate (IAS uses original rate on the transaction, CRD other rates, such as the risk-free rate) could go some way towards solving this problem. However, we believe that the requirements are too granular, especially as regards the data required to calculate economic loss. In this area, we see that there is a reflection of indirect costs in industry practice and that the high level of granularity adds little value. Furthermore, it would be essentially impossible from a technical viewpoint to capture all recovery costs at an entity level. The granularity could in fact lead to an arbitrary inaccurate measurement. The requirements also fail to reflect the development of PDs in relation to LGDs and could act as an obstacle to evolution towards best practices in this fast developing area.

3.3.3.2. Loss Given Default

50. The FBE welcomes the improvements that have been made to the text in this revised section. The section on the discount rate has been improved and we welcome the flexibility included, with the burden of proof on firms to justify the rate they use. We also appreciate an easing in the language outlining the data requirements, in the allocation of costs, and the estimation of methodologies.

51. However there were some key elements of the original text we questioned, and which CEBS has not provided any feedback on:

    Data for economic loss:

    - 199: The definition of realised loss and loss in LGD definition remains unclear and potentially ambiguous (paragraph 168). The word "realised" has been removed in paragraph 168. However, the vague loss definition here remains inconsistent with paragraph 199. For example it is unclear where fees or workout costs count towards losses or not.

Estimation methodologies:

- 230 and 236: "Current market prices of collateral on current exposures will probably influence their estimated LGD". This is not true if a liquidation value approach is pursued, which is common in many institutions. Paragraph 236 has been weakened by adding the word "probably".

- 232: "LGD estimates should incorporate the results of incomplete workouts". This statement makes little sense in particular for workouts with binary payments, e.g. the liquidation of mortgage loans.

- 237: "Use of market prices for defaulted exposures for LGD estimation in case of scarce internal loss data" enforces use of likely unrelated information which is unacceptable. Although slightly weakened this is still critical as risk of conservative misinterpretation at the national level remains.

New text reflecting the work of the AIG and CTF on Downturn LGDs

52. The FBE still has concerns on the inclusion of Downturn LGDs in CP10. We feel that the calculation of downturn LGDs will lead to excessively conservative LGD estimates. Estimating meaningful LGDs for wholesale portfolios cannot be derived from actual data since most banks have limited internal default history. Furthermore, downturn LGDs cannot be used for internal risk management processes like economic capital calculation, pricing or management reporting. They will fail the use test and will also lead to confusion amongst stake holders analysing Pillar 3 information.

53. Although the new paragraphs (paragraphs 219a and 219b, and paragraphs 239a to 239d) largely reflect the work of the joint Accord Implementation Group/ Capital Task Force and the BCBS publication “Guidance on Paragraph 468 of the Framework Document” (July 2005), we note that the clear statements in this Basel paper: "*No material adverse dependencies between default rates and recovery rates have been identified through analysis ..., the LGD estimates may be based on long-run default-weighted averages of observed loss rates or they may be derived from forecasts that do not involve stressing appropriate risk drivers*" has not been included in CP10R. The FBE feels strongly that CEBS should consider including this text.

54. Moreover the statement in paragraph 239a (1) encouraging supervisors to direct firms “to focus their efforts on types of exposures for which they believe the downturn effect is of special concern” could potentially lead to regulatory arbitrage and will result in the guidelines falling along way short of achieving any consistency in implementation across the EU.

55. The text also tries to clarify the definition of LGD versus EL_{BE} on defaulted assets. However the FBE believes that it remains quite confusing. Paragraph 239e states that LGD for defaulted assets must be the sum of EL_{BE} and an add-on reflecting possible additional unexpected loss during the recovery period, where EL_{BE} shall be the credit institution’s best estimate of expected loss for each defaulted exposure given current economic circumstances (according to Annex VII, Part 4(79)). If we assume that, firstly, EL_{BE} represents specific provisions on this particular asset, and, secondly, that this LGD is supposed to cover expected losses

and unexpected losses and is not connected with LGDs which come from the models and are applied to non defaulted exposures:

- This LGD is not used to calculate EL because CRD says that for defaulted assets EL shall be EL_{BE} (Annex VII, Part 1(28)),

- The text says also that for each defaulted IRB retail exposure and each defaulted Advanced IRB corporate exposure (except exposures under the double default treatment), RW shall be:

  Max {0, 12.5 *(LGD-EL_{BE})} (*Annex VII, Part 1 §3 & §9*).

  We can conclude that:

  RW = Max (0, 12.5*add-on_{UL}).

The FBE has a number of concerns in this regard, amongst which:

- It is not clear how this add-on should be calculated;

- The connection with LGD calculated with historical data is not clear;

- It is not clear why this treatment must be applied on an individual basis, even to retail exposures. This makes no sense where the provisions are established on a statistical basis for a whole portfolio.

56. The FBE would ask CEBS to include explicit wording to the effect that the use of non-downturn LGDs in a firm's internal management processes will not, in itself, be regarded as breaching the use test (paragraph 239c almost achieves this objective). We also welcome the reference in paragraph 239d to the overlap between the downturn conditions assumed for estimating LGD and those adopted in some forms of stress-testing. Where a firm assumes 'stress' and 'downturn' conditions that are similar, we agree that the LGD estimates used might also be similar.

3.3.3.3 Conversion Factors

57. The FBE feels that the section on Conversion Factors (CFs) modelling is too prescriptive with too much detail on definitions, time horizons, data and risk drivers. Given that less is known about EAD values and validation, we would expect CEBS to incorporate flexibility through the provision of high level guidance and not detailed rules. We also expect to place great reliance on CEBS' principle of proportionality (paragraph 21).

58. 245: By continuing to include a reference to undrawn amounts in the definition of CFs, this paragraph effectively removes all potential for applying alternative EAD models. While the Directive is flexible on this issue, CEBS should not seek to continue to impose unintended additional restrictive requirements.

59. 246: We welcome that CEBS has restricted its requirements that CFs be estimated for "c*urrent* commitments". We interpret this, and the second bullet of this paragraph, to infer that firms are not required to hold capital for creditor accounts. Until industry thinking has advanced, we strongly discourage CEBS from further prescription in this area.

60. 251-253: We strongly reject the prescription that a time horizon of 1 year is used for estimating CFs, when the CRD is silent on which timeframe should be used. We also reject the requirement that firms can only use other time periods if they can demonstrate that these are "more conservative and more appropriate". We believe that prescription here may result in outputs which are contrary to the requirement of paragraph 143, that "*risk parameter estimates and modelling should be as accurate as possible, reflecting the different types of exposures in portfolios and sub-portfolios".* Firms expect to use the most accurate time horizon for the portfolio. It is also in contradiction with paragraph 242 which states that the *"CF, even more than PD and LGD, depends on how the relationship between institution and client evolves in adverse circumstances…"* which implicitly recognises that in the assessment of CFs, banks should recognise the impact of their policy and processes around managing problem customers.

61. 254: Firms reject the proposal that the momentum approach can only be a "transitory solution" and request recognition of proportionality, whereby for certain portfolios this may be a longer term solution.

62. 261: The attempt to accommodate a broader set of products (e.g. aval lines, as defined in our original response and for which the proposed CF approach is clearly unsuited) fails, as no clear statement is made on what "undrawn" means for guarantees.

3.3.4 Quality of internal documentation

63. 277: This paragraph lists numerous documentation requirements without differentiating between rating development and parameter calibrations. The text appears to refer only to PD ratings and is not appropriate as a requirement for LGD/CF calibrations or modelling. This paragraph is easily misinterpreted, potentially resulting in supervisors requiring the impossible, e.g. a "CF rating system" or "LGD model output calibrated to default probabilities." This is also relevant to our later comments on paragraph 337.

3.4.2 Data quality standards and consistency with accounting data

64. 306: This paragraph states that data quality could be reviewed by replicating the preparation of data and model output based on a sample of data. The data sample as well as the review process could then be audited by the supervisor. This process could mean unnecessary duplication of data preparation (original *and* sample data has to be prepared; the later is checked by the supervisor). No duplicate data preparation should be required for supervisory review purposes.

3.4.3 Representativeness of data used for model development and validation

65. 312: Representativeness and/or comparability analysis require all key characteristics to be similar. The suggested criteria compromise distribution of the population according to the key characteristics and the level and range of these characteristics. This is impractical as not every single driver can be representative in a development or test sample. The additional sentence *"Although it is unrealistic to expect a perfect match in every case, the institution should nevertheless ensure that the distributions are reasonably close"* is insufficient as the wrong key message remains.

3.5.2 Validation tools: Benchmarking and backtesting

66. 337: The definition and measurement of “appropriate margin” is entirely open to regulatory discretion. While we welcome that this is principles-based, we would encourage more emphasis on dialogue with the industry.

67. 340 and 344: The FBE believes the specific guidelines set out in paragraph 340 are inconsistent with the guidance in principle 5. Paragraph 340 states that institutions should take action if internal validation thresholds (i.e. derived from confidence intervals) are exceeded. Thus, paragraph 340 could be interpreted as imposing “hard” thresholds for back testing. Principle 5 (paragraph 333) comprises both quantitative and qualitative elements for validation. This is stressed in the context of benchmarking and low default portfolios. Thus, “hard” thresholds for back testing or benchmarking results (as given here) contradict principle 5.

3.5.3 Low Default Portfolios

68. 352: This paragraph states that limitations owing to the dataset should not exempt institutions from performing their quantitative validation in Low Default Portfolios. This provision remains unchanged. We continue to believe that this represents a contradiction in terms as a lack of data will not allow for useful quantitative validation. We suggest that CEBS include a reference here to supervisory expectations around the amount and relative importance of such quantitative validation techniques in low default portfolio scenarios, where most emphasis and weight is likely to be put on the more qualitative validation methods. The FBE, as past of the International Banking Federation (IBFed) has written to the Accord Implementation Group’s validation sub-group in this regard.

3.6 Internal governance

69. The FBE welcomes the changes made by CEBS in addressing concerns about the level of detail in the internal governance parts of the paper. However, banks are generally concerned about the excessive level of prescriptiveness present in CP10R compared to CP3 regarding the role of senior management. Involvement by either the supervisory level or senior management in details as opposed to strategy and oversight of processes could result in inefficiency and in our view would detract from good risk management practices.

70. 364 and 370b: We are still concerned that the CEBS guidelines on the measure of independence go beyond the requirements intended in the CRD. The proposed guidelines still ask for a split between an institution's Credit Risk Control Unit and Credit Risk Control function. This is not backed by CRD. Even for large institutions, such independence cannot be achieved due to scarcity of skilled staff in general. Furthermore we would urge CEBS to remove the double reference to “audit” in the two paragraphs to refer instead to “another comparable independent unit”.

71. 385: Although the feedback statement claims to have amended the second bullet point to provide clarity, industry remains concerned that this could still be interpreted to mean that risk methodology and validation units may not be part of the same risk management function. This is common practice in many institutions.

72. Concerning the role of the management body and senior management, Section 3.6.1 (and Section 4.3.5 covering operational risk) continues to impose specific, prescriptive obligations on banks' supervisory bodies and senior management in relation to credit (and operational Risk). As we stated before, the requirements could mean that institutions will need to substantially modify board level / senior management committee terms of reference and then spend valuable board and senior management time on issues which could be successfully dealt with either

through delegation or at lower organisational level. We do not believe that this level of detail is consistent with the text in the CRD. We therefore strongly recommend CEBS to review this section and replace it with high level guiding principles.

Section 4: Supervisor's assessment of the application concerning the minimum requirements of the CRD – Operational Risk

73. The FBE has stated its concerns on the operational risk elements of CP10 in the opening remarks to this response. We feel that there is a genuine concern that the guidelines miss the mark in relation to the supervision of this rapidly developing and little understood area of risk management. The following are our detailed comments on Section 4.

74. 417: In case of partial use TSA and BIA, institutions are supposed to meet the TSA qualifying criteria for all business lines. It follows from this that BIA business lines will also have to be subject to complex standards. This contradicts the idea of a partial approach, since a bank will only opt for partial use for gross income segmentation reasons. We, therefore, believe that the qualitative requirements of each approach should also be applied to the corresponding business lines, i.e. compliance with BIA requirements must be sufficient for BIA business lines.

75. 418: It is unclear why the combination LE – TSA with branch – BIA is unacceptable. In the context of an entity using TSA with a foreign branch that solely performs a commercial activity; it is impracticable to force this foreign branch to comply with all TSA qualifying criteria, especially regarding the governance structure. Confirmation is sought, therefore, that in the following cases a firm must only meet AMA requirements at a group level:

    - A firm's individual entities are allocated capital on the basis of the group AMA calculation;
    - A stand-alone AMA model is implemented for individual entities; or
    - The firm uses STA or BIA for individual entities.

76. 429: According to Annex X, Part 4(2) of the CRD, national authorities should be able to impose additional requirements for partial use of an AMA (minimum threshold upon introduction and obligation for complete "roll out") on a case-by-case basis. However, paragraph 429 expresses the expectation that additional requirements are to be imposed in most cases. The CRD provides for permanent partial use as the typical case, even for material units. Consequently, the CEBS proposal cancels out the objective of the CRD, and should be deleted.

77. 442: We find the use of "cross-checking material operational risk data" inappropriate and ask for a more principle-based rewording. Moreover, the current wording implies that such system for cross-checking exists and is implemented uniformly within the organisation. This is impracticable in some areas like trading where losses are buried in the trading profit and loss. The wording should be amended to reflect the 'best effort' basis of the reconciliation effort.

78. Regarding reconciliation to accounting data: We note that paragraph 445 still requires cross checking of loss data to accounting data and to explain material divergences. We believe this is a requirement to reconcile data to the general ledger but that it is impossible for a number of reasons:

    - the use of loss thresholds for data collection;

- the embedding of losses in other accounting/cash flow entries by the time it reaches the General Ledger;

- the difficulty of identifying the loss components arising from a loss event – e.g. staff overtime required to sort out an error.

79. Any approach to the confirmation of data completeness must recognise that firms' ledgers are structured to collect and report information for financial reporting and management accounting purposes and that given the nature of operational losses a neat mapping of one to the other is not possible. Rather firms should be able to verify that their data is of sufficient completeness and accuracy using a combination of techniques appropriate for that organisation. These techniques may include the assessment of the data collection process or the cross checking of data to other available sources (which in some instances may include the general ledger). This would be in line with industry practice. Further verification processes are likely to include management sign-off of the loss. Reconciliation to the general ledger, however, is not always an appropriate tool and as such will not be carried out, so the requirement in the last bullet of Paragraph 445 should be removed.

80. There have been no changes made to the data documentation requirements in paragraph 448. The FBE does not understand why this information is necessary for the approval process for AMA. We would recommend removing the requirement for the database descriptions and the statement of weakness from this section.

81. 449a: We agreed that LDA and SBA approaches are commonly used. However there are other approaches and yet more techniques are likely to evolve. We recommend the rewording of the last sentence to *"(…) be applicable to any AMA approach, either existing or yet to be developed*."

82. 449b: This paragraph should emphasise that examples are offered, but others not mentioned in the text could be equally valid. As we think some of the definitions in paragraph 456 are new and not used by industry we recommend the rewording of this paragraph: *"(…) understanding among competent authorities and examples of the definitions and the interpretation of the most some frequently commonly used Operational Risk concepts."*

83. 450: We propose adding 'Cause' as an operational risk class. The word 'etc' should be deleted as this is not an example.

84. 451 and 452: These two paragraphs should be deleted. Paragraph 451 acknowledges that some terms are used interchangeably – this is itself potentially confusing. We would suggest just one term in each case, and prefer 'distribution' and 'figure'.

85. 453: It seems that the model should be applied consistently across the risk classes. This could pose problems for institutions in which the four key elements of the model are applied at different level of granularity (more detailed for the qualitative ones and, for obvious reasons, less granular for the quantitative ones).

86. It is not clear to us what value is added with the statement in paragraph 455 that *"[t]he chain of processes for evaluating the availability of the four elements should be consistent with the institution's general risk management framework."* We would recommend removing this statement.

87. 456b to 456h: We are not sure that any of the definitions in 456b to 456h are necessary and recommend that they be deleted. Despite CEBS's presumed assumption, these are not descriptions that are recognised by the industry. This will lead to prescription, especially when the proposed definition of a loss event and how to treat it in a model is not based on CRD requirements, and is likely to deter the development of alternative approaches if their methodologies cannot be fitted into these definitions. In particular we are insistent that the terms 'rapidly recovered loss event', 'multiple effect losses' and 'near miss event' definitions are removed. They are not terms used in the CRD and so have no place in CEBS guidelines. Also, in the case of the 'rapidly recovered losses, this information is of little use to an operational risk framework, but is a significant burden to capture; the resources required to capture these losses would be much better deployed in real risk management activities.

88. 456j: This paragraph is confusing – initially referring to insurance policies but then changing to describe rapidly recovered loss event (RRLE) and introducing a supervisory discretion as to the period of time that should evolve for a RRLE. We have two concerns with this: Firstly the introduction of a supervisory discretion which will create an unlevel playing field, and secondly the requirement to collect and categorise information on RRLEs. Industry does not routinely collect such information, is not required to do so and does not want to collect unnecessary data at extra expense. All references to RRLEs should be deleted.

89. 456k: We recommend deletion of this paragraph. Firms should not be told how to treat multiple time losses in their models. In line with a principles based approach they should be required to explain how they treat such losses.

90. 456l: Unless it is a clear requirement of the CRD, CP10R should not specify what should or should not be included in the data set. Some firms may wish to include the absolute value of operational risk gain events where they have been created by a control failure and where they could, had market events been different, have resulted in a loss. This is a decision for the firms to take.

91. 456n: All examples describe the assignment on a loss-event level. Is it intended to rule out other possibilities? If not, the following example could be amended: Capital figures calculated for a centralised function can be assigned to the affected business lines in a well-documented way.

92. 456p: As 456b emphasises it is entirely up to the firm to set loss collection thresholds. 456p seems to require multiple thresholds depending on the risk and complexity of an operational risk class. This requirement is super-equivalent to the CRD. We recommend the deletion of this paragraph and of the following paragraph (456q).

93. 456r: This paragraph suggests that a qualitative adjustment should be made to data that is incomplete, which will lead to difficulties about how the model in which the data is used should be validated. 456r could be more briefly re-written as '*Firms must demonstrate that any bias potentially introduced by the level at which a threshold is set is properly recognised and adjusted for.*'

94. 456u: In the view of the FBE the paragraphs on external data implicitly push firms towards joining consortia: While 456v allows the use of data from public sources where consortia data is insufficient, 456w introduces the possibility that public data could be biased ("ensure that they are appropriate, unbiased (…)").Not all firms wish to join a data consortium and, in reality, data from consortia is no more appropriate and unbiased than public data. Additionally 456u introduces a

requirement regarding how data should be provided to consortia. In our view, these criteria have been, and will continue to be, developed by industry and by the consortia themselves to ensure that the data is of high quality. It is not a matter on which the regulators should provide guidance. We feel that this section improperly prescribes what the 'right' external data is. We, therefore, recommend the deletion of paragraphs 456u and 456w.

95. 456z: Scenario analysis is normally used for generating figures for the tail events. In this section the intention seems to be building scenarios for "normal" events. This should be removed.

96. As with other aspects of operational risk measurement, scenario analysis is still in a phase of rapid evolution. Yet the discussions in CP10R about the number of scenarios a firm should use and their granularity suggest that SBA is more of a science than it really is. Nor are there clearly established statistical tests that would support the number of scenarios to use. We therefore recommend the deletion of paragraph 457a. Although it is a not incorrect commentary on SBA techniques it is not needed in the CP10 guidelines.

97. 457b: The last sentence of this paragraph is helpful to industry as it recognises that it is the firm's decision how to incorporate BE & ICFs into a model. However, the earlier part of the paragraph seems to push firms to use Key Risk Indicators (KRIs), as opposed to self assessment with a subsequent qualitative adjustment being made to the model. In live use by firms BC & ICFs are qualitative modifications to the quantitative output of a model. These modifications should not be prescribed by regulators.

98. 459: It is hard to imagine why the usage of qualitative data in an AMA model should be confronted with the requirement "…to be built by specialists…" We suggest the rewording of this paragraph to *'…AMA models that use qualitative data should be reviewed by specialists, and used with particular circumspection and care.'* As it currently stands the last clause implies a lack of prudence on the part of firms.

99. 460: We suggest the removal of the second bullet as it is impossible to demonstrate.

100. 461c: Dependent loss events within a risk class can be easily modeled by using a Negative Binomial instead of a Poisson distribution for frequencies: The section should be reworded as follows: *"Institutions should seek to identify operational risk classes within which loss amounts are independent and identically distributed. Alternatively, institutions may wish to adjust their data for known drivers in order to simplify the modeling process, which needs to be justified."*

101. 461d: The same holds also for this paragraph regarding stationarity. In addition, together with Annex 5, point 1, this provision on stationarity could be interpreted as also applied to kurtosis and/or skewness measures. Since the existence of these two measures for operational risk should not be taken for grant, it seems not to be appropriate to ask for their stationarity.

102. 461e: The content of this section is in contradiction with the requirement in the appendix regarding the prescribed use of the maximum likelihood estimation since it also warns for the consequences of a low data density, which is often true in the case of operational risk.

103. 461i/j: The reason for the introduction of an internal holding period is not explained. It is introducing further complexity to the CRD which cannot be justified and should therefore be removed.

104. 461l: The recommendation in paragraph 461l to use a historical observation period longer than five years for low-frequency operational risk classes is not covered by the CRD and should therefore be removed.

105. 461n: This sentence refers to data completeness so should be moved to the Internal data section.

106. 461q-461t: These paragraphs propose to scale lower quantiles to the 99.9% quantile in case the 99.9% quantile cannot be calculated in a reliable way. How would it then be possible to come up with reliable scaling factors? These paragraphs should be removed. Otherwise there is a risk that a specific model (e.g. EVT) would be imposed in determining the scaling factor.

107. 461v: The FBE welcomes this paragraph as an example of what can be achieved using a principles-based approach rather than prescription.

108. However, CP10 does not solve the problem of divergence between IAS and CRD. The industry would welcome a more explicit solution in this regard which clarifies that specific reserves for events that have already occurred will qualify whether or not the events are exceptional. IAS37 states that all provisions/specific reserves (whether linked to exceptional events or not) should be recognised if:

    a) an entity has a present obligation (legal or constructive) as a result of a past event;

    b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

    c) a reliable estimate can be made of the amount of the obligation.

    This shows that previsions/specific reserves are by their nature linked to events that have already occurred and that this characteristic should not prevent them from being an EL off-set.

Correlation

109. As stated in the introductory statement, the section on correlation in relation to operational risk losses sets much high standards than are required, either in the advanced IRB approaches or the market risk VaR correlations standards, as well as being super-equivalent to the CRD. The regulatory presumption is that events, especially those in the tail, are correlated with a value of >1 or higher. This is a significant change to the regulatory position from discussions that have taken place over the past few years. In contrast, the common agreement in the industry is that correlations between different risk classes are generally very low. The proposed correlation assumptions contradict the empirical experience, industry practice, and the supervisory approaches to other risk classes, and therefore, should be removed.

110. The tone of the paper indicates that the validation standards applied by the regulators will be very high. It is not clear that the regulators have themselves adopted the same validation standards when considering the correlation elements of the IRB, or insist upon the same standards for Market Risk VaR models. An

implication is that in order to meet the regulatory validation standards, for correlation between tail events, banks will have to experience more tail events. The suggestion that banks should have more tail events will not be pleasing to line supervisors, nor to the senior management of banks. Furthermore, as banks enhance their management of tail events, then data will become scarcer, making validation more difficult and possibly penalising firms that are improving risk management, through the regulatory imposition of correlations of 1 or higher.

111. For operational risk, the combination of an assumed correlation of 1 (or higher) and validation standards could result in the overall capital charge for operational risk being the sum of individual risk measures. This increase in the capital charge will reduce the likelihood that banks will use the AMA and instead revert to the Standardised Approach for capital purposes. These same banks may nevertheless continue to use the AMA for economic capital purposes, thereby increasing the divergence between regulatory and bank approaches to risk management, missing one of the objectives of Basel 2 and the CRD.

112. CEBS should justify why it believes higher standards than in the IRB or VaR approaches are required for operational risk. Supervisors should be very wary of unnecessarily raising the bar in these other areas as a result of the AMA requirements.

113. 461x: The measurement of correlations among the so called tail events can be hardly measured given the low data density. Moreover from a quantitative perspective it is to be expected that the loss events in the tail-area are independent from each other by nature. The whole discussion regarding correlations among tail events show that the requirements are beyond reality. They should be removed.

114. 462a: This paragraph is critical.

- 462a states that *"[I]n particular, institutions should calculate the overall AMA capital charge as the sum of the individual risk measures only if they ensure that they do not underestimate the dependencies of the tail events."* In the view of the FBE this requirement is not in line with the empirical experience in the banks and contradicts existing scientific papers (e.g. *The Correlation Problem in Operational Risk,* Frachot, A., Roncalli, T and Saloman E, Crédit Agricole S.A., France, January 23, 2004) which clearly show that correlations or other dependency measures do not have a significant influence on the overall capital measure. While the influence of the body and tail events is different, it is not necessary from a technical perspective to make a distinction between correlations in the body and tail area. The high severity losses can only be classified as extremes if they show a strong independence. Otherwise those risks cannot be seen as extremes. If the losses have the same cause, they will be grouped to one single data point. This demonstrates that tail events should not show any dependencies.

- Secondly there is an inconsistency with respect to §461x. In 461x it seems that the sum is a conservative and accepted measure. Instead in §462a there seems to be an exception to this conservative assumption. This could lead to situation in which a bank could be forced to calculate measures of correlation even if CRD Annex X Part 3, point 11 clearly states that this should not be the case unless a bank intends to validate its correlation measures.

- We are extremely concerned that the suggestion of the concept of potential super-additivity of risk should be factored into the overall capital charge. We do not believe that this topic has been sufficiently examined to require anything more than is required by the CRD – that is, that the worst possible case position is

100% correlation, resulting in the addition of tail event capital requirements. Until it can be demonstrated that in operational risk terms 1+1>2, straightforward addition should be the worst-case, last-resort assumption. We therefore recommend deletion of the final sentence of this paragraph.

- In addition there seems to be a contradiction between:

  462a) and the example of Annex 8 "where a common factor generates simultaneous tail events in different classes (e.g. damage to physical assets or failure of IT data storage facilities)" and 456K (multiple time losses and multiple effect losses have to be aggregated in on single event before entering in the calculation data set) and 461y, 461c, 461d (risk class i.i.d.). In fact, ones a banks has fulfilled the rules in the second bullet there is no risk of "simultaneous tail events in different classes" simply because only one loss will exist in one of the two ET considered in the example.

Taking all of the above comments into account, the FBE believes that paragraph 462a should be substantially redrafted or deleted from the paper.

115. 462c: We do not really understand this paragraph. Replacing 'Structural dependencies' with 'correlation' might help, but we disagree that correlations should be treated only in the input phase. A firm's approach to this issue will be dependent on its particular model. Regulators should not prescribe a particular treatment. We therefore suggest deletion of the words '…. before the modelling phase'.

116. 462e: This should be deleted and Paragraph 462f reworded as follows: *"The soundness of dependency assumptions which have a material impact on the overall AMA measure should be demonstrated (…) of stress-tests analyses."*

117. *Insurance and other risk transfer mechanisms*: We would like to see a more flexible and pragmatic approach by regulators:

- Restrictions in term of minimum rating of the insurer. This is crucial since in many cases insurance are taken with pools of companies some of which could be rated (or even unrated) less than the prescribed level;

- Treatment of the initial and residual term of the insurance policies.

The CRD recognises insurance as a sound operational risk mitigants. Given the evolution in this field, both on the banking and insurance side, a flexible supervisory approach is essential.

118. There is however a need for guidance relating to the CRD provision which applies a haircut three months prior to the end of an insurance policy when AMA banks have a clear and well-defined renewal process. This provision is not realistic and banks do not know how to manage it. In the extreme case, and following the proposed logic, it would mean a financial institution would need 20% more capital on December 31 (last day of existing policy) vis-à-vis January 1 (first day of new policy). It would be useful for CEBS to provide reasonable and pragmatic principles on how to deal with these instances.

119. 462h: It is unclear to us why outsourced activities should be excluded from other risk transfer mechanisms. Banks already assess the risk of outsourcing and include it in their model, and we recognise that outsourcing does not completely transfer

risk. However, where there are robust centralised obligations between the firm and its outsourcer it should be permitted to include as its event value the gross loss less the value of any recoveries from the outsourcer, in the same way as insurance recoveries would be treated.

120. 463b: We suggest the merger of this paragraph with 463e, to read *'An institution should have an internal validation process to ensure that elements of its methodology affected by a significant change in its operational risk profile or assumptions are revalidated. The internal validation process should be proportionate and take into account the specific purpose for which the operational risk measurement systems are used.'*

121. 463f: We question how we can demonstrate that information is as accurate and complete as possible. We therefore suggest adding a final clause to this sentence: *'and as complete as practicable, having regard to its pre-determined cut off levels and the cost and benefits of any such information verification'.*

122. 463j: The requirement that "all" data above the threshold be validated is costly and adds little value to the AMA calculation process. We suggest "data above the threshold should be subject to proportionate validation, taking into account the impact of the data upon the AMA calculation results." We assume that 'constructed' data means external data and recommend that the wording be changed to reflect this. The last sentence should be changed to read 'where external data is used it should be subject to proportionate review and challenge.'

123. 463m: CEBS's advice to regulators focuses on the calculation of regulatory capital. The reference to economic capital should be deleted.

124. 463n: This sentence should be deleted. We do not understand how a methodology can be validated until it is built. Model construction is an iterative process.

125. 463o: There is concern that Annex VI will be converted into a regulatory checklist, forcing banks to use techniques that may not be necessary and giving regulators false comfort in a list.

126. 463q: For the first time in CP10r KRIs are mentioned. The reference to KRIs should either be deleted or the word 'might' inserted before the first bullet, to read: *'These might include verifying that:'*

127. 466: We are surprised that the regulators believe that firms accept operational risk passively. They do not and devote significant resource to mitigating it. We would prefer the deletion of the words '…*is taken on passively and…'*

128. 469: We suggest the last two sentences should be reworded as follows *'The management body should have a general awareness of the AMA framework used by their institution. Senior management may delegate certain tasks but remain responsible for implementing and developing the AMA framework.*

129. 470: We do not believe it is possible for the management body and senior management to have a detailed comprehension of an operational risk framework's associated management reports. The second sentence should be reworded as follows: T*hey should have a general understanding of how operational risk affects the institution, of the overall operational risk framework and a detailed comprehension of the operational risk management reports presented to them.'* Furthermore, we think that the requirement that the operational risk framework be

required to specify levels of acceptable risk is super-equivalent to the CRD. The 4th bullet point should be deleted.

130. 474: The 9th bullet introduces a requirement that senior management (which we take to mean those individuals heading a firm's operational risk team) should assess operational risks in new areas before they are introduced is unrealistic in some cases. For instance it is unlikely that such senior management would be involved at the due diligence stage before an acquisition was completed. We suggest deletion of the working 'before they are introduced'.

131. 481: The reference to economic capital should be deleted.

132. 482: We do not think it is yet possible to back test or benchmark the quantification and allocation processes. This sentence should be re-written as: *"(…) Insurance), where sufficient data is available, benchmarking and/or back testing and (…)"*

Annex V

133. While we strongly support the statement in the heading that these are a non-exhaustive and non-binding list of examples, we fear they will become very like a checklist in the eyes of users, thus channelling the development of the execution phase of an AMA model. We therefore recommend the deletion of this Annex.

Annex VI

134. We recommend the deletion of this Annex for the same reasons as immediately above.

Annex VII

135. For the same reasons we prefer deletion of this Annex, or at least the replacement of the first line with the words: *'The following is a non-exhaustive and non-binding list of elements that may represent good practice of the model output.'*

Annex VIII

136. We believe that the CRD permits addition of risk measurements, implicitly assuming a 100% correlation as strictly a worst case. The last sentence of paragraph 3, referring to the 'science' of non-subadditivity should be deleted.