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Ihr Zeichen, Ihre Nachricht vom Unser Zeichen, Sacharbeiter Durchwahl Datum

BSBV 115/Dr.Egger 3137 12 September 2014

**EBA Consultation on Technichal Standards on assessment methodologies for the Advanced Measurement Approach for operational risk under Art. 312 CRR**

The Division Bank and Insurance of the Austrian Federal Economic Chamber, as representative of the entire Austrian banking industry, appreciates the possibility to comment on the EBA-consultation on Technichal Standards on assessment methodologies for the Advanced Measurement Approach for operational risk under Art. 312 CRR and would like to submit the following position:

Beside the answers to the questions raised by EBA (page 80) we also added a list of questions and remarks that emerged when analysing the paper (please see the attached table). With these questions we want to show the regulator our concerns and/or open points with the Draft RTS. We would highly appreciate if the answers would be incorporated in the final paper.

**EBA’s Questions**

*Q1: Are the provisions included in these draft RTS on the assessment methodologies for the Advanced Measurement Approaches for operational risk sufficiently clear? Are there aspects that need to be elaborated further?*

Answer:

Overall the provisions are sufficiently clear and promote higher level of homogeneity and common understanding of the AMA framework. The specific comments and questions can be found in the attached file.

*Q2: Do you support the treatment under an AMA regulatory capital of fraud events in the credit area, as envisaged in Article 6? Do you support the phase-in approach for its implementation as set out in Article 48?*

Answer:

Yes, we support the treatment of fraud events in the credit area upon clarification of whether this change is retroactive or not and after alignment of the gross loss definition with the accounting standards used in credit risk area (e.g. Specific Loan Loss Provision in IFRS). Regarding implementation there is timing issue as the fraud investigation (coupled with police process) can take long time until the fraud is proven, therefore these cases can be considered in credit risk (scoring/rating) for an interim period.

Furthermore, we propose that the integration of first and third party fraud events in the AMA and subsequently the exclusion of these events from credit risk shall be reconciled with the authority for credit risk.

Yes, we support the general phase-in approach of one year, but we propose an extension of the phase-in for Article 6(1) to four years from the entry into force. The extension is necessary in order to collect first and third party events for at least three years and to develop an AMA model suitable for these data.

Moreover we would like to submit some concerns which relate to the following practicalities.

Firstly, the experience showed that making progress on this topic and achieving the clarity requested by the EBA will require consistent and transparent support from the regulators specializing in Credit Risk. Operational Risk Managers cannot be expected to comply with these requirements if there is incomplete regulatory support for the change.

The change will have an impact upon regulatory capital calculations and the capital estimates generated as a result. This will have an impact upon the Credit Risk Management function. The Credit Risk Management function cannot be expected to make such significant changes if the changes are not actively supported by the Credit Risk regulators.

It is anticipated that a Regulatory Technical Standard will be published for Credit Risk. We will look for clauses with the same effect as Article 6 in that document.

Secondly, the level of granularity at which these requirements are to be applied is unclear. For example, is it a single transaction with a customer, or once a fraud has been detected it is assumed to apply to all transactions involving the same product or all transactions across all products with the same customer?

It is proposed that the EBA ask Credit Risk Management functions about the level of granularity that are applied today and then issue guidance promoting consistency.

Thirdly, there is the threshold at which this data is to be captured. The ORX Operational Risk reporting Standards currently use a threshold of €500,000. If the threshold for investigating whether a credit loss is a fraud or not is reduced significantly then the resources required, to meet this requirement, could be substantial. While a firm may have 100s of credit losses of €500,000 this number will increase substantially if the threshold is reduced significantly, for example 100,000s.

The number of events presents system and data collection issues. However, there is also the question of skilled resources to determine whether a fraud has or has not been committed. Currently the determination about fraud involves forensic accounting skills. It is not clear if the credit department currently has the level of resources required to conduct the analysis on this potential volume of losses. The choice of initial data collection threshold, for these losses, will heavily influence whether two years is sufficient time to begin data collection.

Fourthly, it is unclear who is in charge of the burden proofing the fraud relation in credit related cases.

Sixthly, for banks planning to apply for the AMA in 2015 it is unclear what is expected. External losses will not apply the same standards as internal losses as long as the other AMA units apply for these standards. Internal data will not be available for the expected time frame now backwards.

Seventhly, from a measurement point of view, the possibility of exposure-based models should not be made impossible for an accurate modelling of fraud events in the credit area. Simply modelling these losses in an LDA would discard the additional information of the exposure.

*Q3: Do you support the collection of ‘opportunity costs/loss revenues’ and internal costs at least for managerial purposes, as envisaged in Article 7(2)?*

Answer:

While “opportunity costs / lost revenues” (Article 7 §2) may influence the economic value of the firm there are practical issues to consider. The practical issues include how to estimate these values with a degree of consistency across the businesses and event types and a degree of accuracy.

Given that it is unlikely that this practical issue will be resolved in the very near future, it is proposed that “opportunity costs / lost revenues” should be deleted.

Theoretically “internal costs such as overtime or bonuses” contribute to the total impact of an operational risk event upon the firm. However, the general ledger is not set-up to provide this information on a regular basis. For functions closely linked to the control environment, for example compliance, or reconciliations, or payments, or the legal department, their total HR costs are known.

In exceptional circumstances, for example a particularly large remediation project, then the cost of allocated internal staff may be available, but may not separately show overtime or bonuses.

It is proposed that “internal costs such as overtime or bonuses” should be deleted.

*Q4: Do you support the items in the lists of operational risk events in Articles 4, 5 and 6, and the items in the list of operational risk loss in Article 7? Or should more items be included in any of these lists?*

Answer:

**Article 4:** “Operational risk events related to legal risk” name prompts a boundary risk type and legal risk is rather a secondary effect for most of the OpRisk events. The “risk of being sued” is very broad category so complete identification of these cases is hardly possible.

Marking OpRisk events as legal cases (really being sued or being subject of a claim) could be more appropriate solution as events originally classified in accordance with the primary risk driver.

**Article 6:** The par. 2(b) fraudulent use of credit funds event can include the cases when a client uses a loan not for the intended purpose and the fraud definition is limited to no intention of any repayment.

The par. 2(d) loan application by client using fictitious identity can happen with stolen identity.

In this article we miss a definition for the boundary between operational risk and credit risk, otherwise operational risk could be interpreted too broadly.

**Article 7:** We support the listed items in paragraph 1 with the exception of uncollected revenues where the quantification is [unambiguous](http://szotar.sztaki.hu/search?searchWord=unambiguous&fromlang=eng&tolang=ger&outLanguage=hun) and the lack of clear distinction in the business decisions (e.g. for waiving fees for OpRisk event or other factors could have been also taken into account like client’s bargaining position).

*Q5: Do you support that the dependence structure between operational risk events cannot be based on Gaussian or Normal-like distributions as envisaged in Article 26 (3)? If not, how could it be ensured that correlations and dependence are well-captured?*

Answer:

In 26(3) the guidance states that “The dependence structure shall not be based on Gaussian or Normal-like distributions”, in this case more clarity would be welcome on what constitutes a “Normal-like” copula, in particular at what point the number of degrees of freedom of a t-copular mean the copula is “Normal-like”.

The stated limitation on the number of degrees of freedom “with few degrees of freedom (e.g. 3 or 4) in most cases appears more appropriate to capture the dependencies between operational risk events” seems particularly restrictive, and may not be appropriate in some situations.

More flexible guidance could state that “The dependence structure shall not be based on assumptions that rule out high level of tail dependence a-priori (e.g. by using a Gaussian copula).”

*Q6: Do you support the use of the operational risk measurement system not only for the calculation of the AMA regulatory capital but also for the purposes of internal capital adequacy assessment, as envisaged in Article 42 (d)?*

Answer:

We fully support the application of the AMA framework for the purposes of internal capital adequacy assessment. But here we would like to point out that the output of the two models can be materially different due to the scope of consolidation and the confidence level at which the VaR is measured.

Please take our remarks into due consideration.

Yours faithfully,

Dr. Franz Rudorfer

Managing Director

Division Bank and Insurance

**Annex**

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| **Article 1: Scope of Operational Risk** |  |
| Para 2 | *“The competent authority shall verify that an institution has included legal risk, information and communication technology risks, as well as model risk, within the scope of operational risk with the exclusion of other kinds of risk.”* |
| Comment | Model Risk is not defined in the document, but is referred to in several places. Art 5 §2c, Art 5 §3h & I, Art 5 §5a & b. A distinction is drawn between models that have been through an internal review process, use the correct inputs, but give a “strange” answer due to the assumptions embedded in the model being breached and those that have not been reviewed or implemented incorrectly or use the wrong inputs.  Without a definition or description of model risk then it is possible for its scope to be extended in unexpected ways, for example to include budgeting. |

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| **Article 1: Scope of Operational Risk** | |
| Para 2 | *“The competent authority shall verify that an institution has included legal risk, information and communication technology risks, as well as model risk, within the scope of operational risk with the exclusion of other kinds of risk.”* |
| Comment | The scope appears to be missing issues related to people – including ethics and culture, organisation, and process failures.  The statement on exclusions is confusing especially as these “other kinds of risk” are not described. If risks such as Business, Strategic and Reputational are to be excluded (as per the definition of operational risk) then it will be better to mention them explicitly. |
| Suggestion | The scope of operational risk is missing some important elements from the definition of operational risk, in particular processes, systems, people or external events.  The reference to “the exclusion of other kinds of risk” is adding uncertainty to the scope. It would be preferable for these other risks to be labelled, for example Business, Project, Strategic and Reputational Risks. The alternative is to delete “the exclusion of other kinds of risk”. |

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| **Article 2: Definitions** | |
| Para 12 | *“‘legal risk’ means the risk of being sued or being the subject of a claim or proceedings due to non-compliance with legal or statutory responsibilities and/or to inaccurately drafted contracts. It also includes the exposure to newly enacted laws as well as to changes in interpretations of existing laws. “* |
| Comment | Depending upon the jurisdiction, firms can be sued for a wide variety of issues, for example for technical reasons in some countries just to change contract owners. As a result the “risk of being sued” is too broad and impractical. If a firm is being sued then there is no risk or uncertainty. |
| Suggestion | Due to the influence of jurisdiction on the likelihood of being sued and the range of potential lawsuits it is recommended that this element of the definition is deleted. The definition would become “*Legal Risk means the risk of loss from non-compliance with legal or statutory responsibilities and/or inaccurately drafted contracts. It also includes the exposure to newly enacted laws as well as to changes in interpretations of existing laws.*” |

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| Art. 2(14) | ‘operational risk category’ means the level (such as the institution’s organizational unit, operational risk event type, business line) at which the institution’s operational risk measurement system generates a separate distribution for estimating potential operational losses. An operational risk category is homogeneous when its data are of the same or similar nature under the operational risk profile, independent when no form of dependence or correlation is identifiable across it, stationary when the characteristics of the data does not change when shifted in time or space; | Operational Risk Category | We suggest to use "unit of measure" instead of "operational risk category" |

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| **Article 2: Definitions** | |
| Para 20 | *“‘pending losses’ means losses stemming from operational risk events, which are temporarily booked in transitory and/or suspense accounts and are not yet reflected in the P&L statement. The impact of some events, such as legal events, internal frauds, damage to physical assets, may be known and clearly identifiable before these events are recognized through the establishment of a reserve;”* |
| Comment | The concern appears to relate to perceived or actual misuse of suspense accounts and pending losses in relation to operational risk losses. These items are probably pending losses while the more certainty is achieved over the loss estimate, for example is it €10 Million or €10,000.  The finance / accounting / control function operates pending losses and suspense accounts within the formal accounting standards.  For clarity the second portion of the definition should be deleted. |
| Suggestion | The operation of pending losses and suspense accounts are governed by the accounting standards. It is recommended to clarify the definition be deleting the sentence “*the impact of some events, such as legal events, internal frauds, damage to physical assets, may be known and clearly identifiable before these events are recognized through the establishment of a reserve*” |

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| **Article 2: Definitions** | |
| Para 21 | *“‘‘recovery’ means an independent occurrence related to the original operational risk loss that is separate in time, in which funds or inflows of economic benefits are received from a third party, such as insurers or other parties “* |
| Comment | Market practice is to take direct Recoveries which occur beyond the 5 day time period not into consideration.  The issue is that the requirement for a recovery to come from a third party is overly restrictive and unnecessary. |
| Suggestion | It is recommended that a more granular approach is taken to recoveries, specifically recognising rapid recoveries (Art 8 §2), recoveries from insurance companies and direct or other recoveries. The difference between a rapid recovery and direct recovery is one of timing. The direct recovery may not come from a third party but from the increased value realised when selling assets possessed following a fraud.  Moreover why is the term third party only mentioned? (e.g. employee) |

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| **Article 2: Definitions** | |
| Para 27 | *“‘timing losses’ means negative economic impacts booked in an accounting period due to operational risk events impacting the cash flows or financial statements of previous accounting periods. Timing impacts typically relate to the occurrence of operational risk events that result in the temporary distortion of an institution’s financial accounts (such as revenue overstatement, accounting errors and mark-to-market errors).”* |
| Comment | For clarity the accounting should refer to the formal annual accounts. |
| Suggestion | It is recommended, for clarity that **“annual”** is inserted into the definition. For example, *‘timing losses’ means negative economic impacts booked in an annual accounting period due to operational risk events impacting the cash flows or financial statements of previous annual accounting periods. Timing impacts typically relate to the occurrence of operational risk events that result in the temporary distortion of an institution’s annual financial accounts.* |

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| **Article 4: Operational Risk Events related to Legal Risk** | |
| Para 2 b | *“The definition in paragraph 1 shall include the following events:*  *events related to decisions made by an internal competent decision-maker but breaching legislative or regulatory rules, internal rules or ethical conduct. “* |
| Comment | The reference to “internal rules” appears to effectively extend the scope of legal risk. In addition, it is not clear if these “internal rules” are principles, policies, standards or procedures.  “Ethical conduct” suffers from some of the same concerns as “internal rules”. Presumably if a firm is acting unethically then there will be issues around “legislative or regulatory rules”. |
| Suggestion | Uncertainty is created about the exact nature of the internal rules (whether principles, policies, standards or procedures) and about the scope of legal risk. For clarity it is proposed to delete some text so that the paragraph becomes “*events related to decisions made by an internal competent decision-maker but breaching legislative or regulatory rules”.* |

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| **Article 4: Operational Risk Events related to Legal Risk** | |
| Para 3 b | *“As a specification of the paragraph 2, the following cases shall be included within the scope of application of paragraph 2, points (a) or (b):”*  *“expenses stemming from legal disputes or from interpretations of legislative or regulatory rules which prove to be against industry practice “* |
| Comment | The reference to industry practice is confusing. A number of industry practices have been found to be against “legislative or regulatory rules”. |
| Suggestion | For clarity it is proposed to delete some text so that the paragraph becomes “*expenses stemming from legal disputes or from interpretations of legislative or regulatory rules”.* This will remove potential confusion about the status of industry practices, some of which have been found to be against “legislative or regulatory rules”.  Moreover, please delete the "which prove to be against industry practice" as it is hard to define what is the industry practice and in many cases the standard industry practices are also questioned. |

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| **Article 4: Operational Risk Events related to Legal Risk** | |
| Para 4 | *“Events due to decisions or radical changes in the business environment, lack of responsiveness to changes in the business environment or improper implementation of decisions which did not breach any legislative or regulatory rules, internal rules or ethical conduct shall not be ascribed to operational risk. “* |
| Comment | This paragraph should be amended to provide consistency with paragraph 2b. |
| Suggestion | For clarity it is proposed to delete some text and achieve consistency with the proposal for paragraph 2b. The paragraph becomes “*Events due to decisions or radical changes in the business environment, lack of responsiveness to changes in the business environment or improper implementation of decisions which did not breach any legislative or regulatory rules shall not be ascribed to operational risk.”*  Moreover, we propose to have an explicit definition of business/strategic risk and not the distinction between operational risks. |

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| **Article 4: Operational Risk Events related to Legal Risk** | |
| Para 5 a | *“As a specification of the paragraph 4, the following events, and the related losses, shall be excluded from the scope of operational risk:”*  “*events incurred by an institution as a result of senior management’s decisions or business choices, which do not breach any legislative or regulatory rule, internal rules or ethical conduct, or which are not triggered by legal risk; “* |
| Comment | Examples could include various forms of business or strategic risk. Given the exclusions from the definitions it would be helpful if the same terminology could be used here. |
| Suggestion | From the perspective of consistency with the definition of operational risk, it would be useful to explicitly mention Strategic and Reputational Risks as being excluded. |

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| **Article 4: Operational Risk Events related to Legal Risk** | |
| Para 5 d | *“As a specification of the paragraph 4, the following events, and the related losses, shall be excluded from the scope of operational risk:”*  *“refunds to customers and goodwill payments due to business opportunities, where no breach of legal or regulatory rules or ethical conduct have occurred. This applies only where the clients/counterparts are entirely at fault and an institution has fulfilled its obligations, such as reminding the clients or counterparts of their obligations on a timely basis.“* |
| Comment | This relates to exclusions. The issue is complexity of the text. A much simpler text is suggested below. |
| Suggestion | For purposes of clarity it is recommended that the same effect can be achieved with fewer words.  *“All payments to customers that are not compensation or restitution for operational risks events incurred by the firm.”* |

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| **Article 5: Operational Risk Events related to Market Risk** | |
| Para 1 | *“Operational risk events occurring in market-related activities shall be classified as boundary events between operational risk and market risk. These events, and the related losses, shall be included within the scope of operational risk for the purpose of calculating the AMA regulatory capital “* |
| Comment | This paragraph needs to be re-worded to focus upon operational risks associated with transactions, in general, as opposed to just market-related activities. Especially, as the internal treatment of market-risk activities should not distract from the point. |
| Suggestion | For consistency with the proposed label, this text needs to be amended.  *Operational risk events arising from transactions shall be included within the scope of operational risk for the purpose of calculating the AMA regulatory capital. These transactions may take place in anywhere across the group, for example Trading & Sales or Retail banking business lines.* |

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| **Article 5: Operational Risk Events related to Market Risk** | |
| Para 2 c | *“The definition in paragraph 5(1) shall include the following events: “*  *“events due to wrong selection and/or implementation of the model, made outside a defined business process/formalised procedure and without a formalized, conscious risk-taking process; and “* |
| Comment | The issue here is the scope of model. This is connected to “model risk” and its lack of definition in Article 2. (see above comments on Article 1) |
| Suggestion | Models and model risk are included in the scope of operational risk. However, the lack of a definition of model or model risk in Article 2 creates uncertainty about the interpretation and practical scope of this paragraph.  If model risk is defined then this paragraph may no longer be needed. A definition of model risk could be “the incorrect selection, and/or computer implementation of or data inputs for a model or its use for purposes outside those for which the model was approved. The approval of a model is an independent formalised procedure or business process.” |

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| **Article 5: Operational Risk Events related to Market Risk** | |
| Para 2 d | *“The definition in paragraph 5(1) shall include the following events: “*  *“events due to inadequate data quality and unavailability of IT environment* “ |
| Comment | Paragraph 2 appears to be missing any reference to data entry errors. This may be implied by paragraph 2d, but it is not clear. |
| Suggestion | For clarity, it is proposed to add a reference to data entry errors to Article 5 paragraph 2d. *“events due to inadequate data quality, including data entry errors, and unavailability of IT environment.”* |

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| **Article 5: Operational Risk Events related to Market Risk** | | | |
| Para 3 b | | *“As a specification of the paragraph 5(2), the following cases shall be included within the scope of application of Article 5(2), points (a), (b), (c) or (d) respectively: “*  *“errors in classification due to the software used by the front and middle office; “* | |
| Comment | | From an unscientific poll, it appears that errors in data entries account for as many if not more errors than software errors. | |
| Suggestion | | For clarity, it is proposed to add a reference to data entry errors to Article 5 paragraph 3b. *“errors in classification due to data entry errors and/or the software used by the front and middle office.”* | |
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| **Article 5: Operational Risk Events related to Market Risk** | | |
| Para 3 g | *“As a specification of the paragraph 5(2), the following cases shall be included within the scope of application of Article 5(2), points (a), (b), (c) or (d) respectively: “*  *“unauthorised market positions taken in excess of limits; “* | |
| Comment | Operational Risk losses can arise when unauthorised positions are taken; it is not limited to market positions. These positions could be in relation to purchasing, recruiting staff, on granting credit lines. | |
| Suggestion | For clarity and consistency, it is proposed to amend Article 5 paragraph 3g to *“positions taken in excess of allocated limits, whether market, credit, liquidity or other risks.”* | |

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| **Article 6: Fraud events in the Credit Area** | |
| Para 2 | *“The definition in paragraph 6(1) shall include the following events:*  *(a) lending decisions based on counterfeit documents or miss-stated financial statements, such as non-existence or over-estimation of collaterals and counterfeit salary confirmation;*  *(b) fraudulent use of credit funds;*  *(c) loan application fraud through phishing and using clients data;*  *(d) loan application by client using fictitious identity;*  *(e) fraudulent use of clients’ credit cards by third parties “* |
| Comment | The impression given is that fraud is only committed at the beginning and not during the life of a transaction. |
| Suggestion | For consistency and clarity, Article 6 §2 needs to be amended. The draft treatment is that only fraud committed at the beginning of a transaction is to be treated as operational risk. So if fraudulent details are provided during the life of a credit transaction then the fraud is still to be allocated to Credit Risk. If this is what is intended then it would lead to an inconsistent capital treatment of fraud – sometimes OR and sometimes CR depending upon the timing of the fraud. |

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| **Article 6: Fraud events in the Credit Area** | |
| Para 3 | *“The competent authority shall verify that the institution adjusts the data collection threshold relating to the loss events described in Article 6(1) up to levels consistent with those adopted for the collection of the loss events pertinent to the other operational risk categories of the AMA framework “* |
| Comment | A firm may use a threshold of €5,000 to collect its internal operational risk data. The same firm may use a threshold of €10,000 for modelling a particular unit of measure – operational risk category. The EBA proposal is that this €10,000 should also be used to investigate credit losses to see if there is an element of fraud.  The prior comment relates to the efforts required to collect the volume of data. There are additional resource implications, the specialists who conduct forensic analysis to determine if a fraud has or has not been perpetrated. A non-scientific poll indicates that it can take over 3 months to arrive at a conclusion over whether a fraud has or has been committed. |

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| **Article 6: Fraud events in the Credit Area** | |
| Suggestion | There are some practicalities that should be considered in relation to Article 6 §3. Presently the thresholds for collecting operational risk loss data relate to the business line and their operational risk appetite. Requiring the initial data collection of fraud in the credit risk space at the same threshold is expected to raise a significant implementation challenge.  In addition to the system challenges there may also be the need to recruit additional staff to perform the forensic analysis in order to determine whether a fraud has been committed. This forensic analysis can take over three months.  It is proposed that for an initial phase a relative high threshold is used (for example €500,000) which can then be lowered by companies overtime as the benefits are assessed. |

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| **Article 6: Fraud events in the Credit Area** | |
| Para 4 (1) | *“‘first party fraud’ means a fraud that is committed by an individual or group of individuals on their own account with no intention of any repayment of the loss caused. A first party fraud generally occurs when the party misrepresents its financial abilities on the application forms and by using another person's identifying information. Any fraud which is initiated at a later stage of the lifecycle of a credit product, such as the misstatement of financial reports, even when it is used to prolong or to extend an existing credit product does not fall within this definition “* |
| Comment | There seems to be some overlap with the description of “third party fraud”. |
| Suggestion | For clarity, it is proposed to make changes to Article 6 §4.1. This paragraph refers to “*using another person’s identifying information*”. This appears to be more closely aligned with Third Party Fraud. As a result it is proposed that “and *using another person’s identifying information”* should be deleted.  If first and third party fraud events would be included in the AMA approach, the AMA capital increases. The basis for BIA and TSA capital charge calculation is the gross income. This income is not affected by first or third party fraud, therefore the capital charge from these approaches will not increase. This leads to a bias in the capital charge for BIA/TSA and AMA approaches. Is any action planed to deal with this issue?  Third party fraud is not self-explanatory alternative term "Identity theft" would be more useful. |

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| **Article 7: Scope of Operational Risk Loss** | |
| Para 1 d | *“For the purpose of calculating the AMA regulatory capital, the scope of operational risk loss shall include the following items “*  *“pending losses that are recognised to have a relevant impact. Pending losses shall be included within a time period commensurate to the size and age of the pending item. For this purpose, consideration shall be given to the recognition of pending losses actual amount in the loss database or pertinent scenario analysis; “* |
| Comment | A few changes to the drafting could improve this requirement. |
| Suggestion | For clarity, it is proposed to amend Article 7 §1 d. The main reason that firms use pending losses and suspense accounts is due to the fact that they do not know the actual amount of the loss. It is proposed to delete “actual” so that the phrase becomes “*recognition of the pending loss amount in the loss database*”. This will need to be included in the AMA calculations by date of occurrence as the loss estimate has not yet been recognised in the P&L.  The inclusion of “pertinent scenario analysis” when used in a paragraph on pending losses is confusing and should also be deleted. |

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| **Article 7: Scope of Operational Risk Loss** | |
| Para 1 e | *“For the purpose of calculating the AMA regulatory capital, the scope of operational risk loss shall include the following items “*  *“uncollected revenues related to contractual obligations with third parties, such as the decision to compensate a client following the operational risk event, rather than by a reimburse or direct payment, through a revenue adjustment waiving or reducing contractual fees for a specific future period of time; “* |
| Comment | Uncollected Revenues are difficult to collect. When combined with the loss data collection threshold proposed for Credit Risk and regulatory verification this looks like a difficult standard to meet. |
| Suggestion | It is recognised and appreciated that uncollected revenues are an economic loss to the firm. However, capturing these losses is difficult. One potential data source, the General Ledger, is used to tracking things that did happen rather than things that did not happen. Firms should be able to agree a threshold, with their home regulator, for capturing uncollected revenues. |

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| **Article 7: Scope of Operational Risk Loss** | |
| Para 1 f | *“For the purpose of calculating the AMA regulatory capital, the scope of operational risk loss shall include the following items “*  *“timing losses that span more than one accounting year and give rise to legal risks.*”  “ |
| Comment | It is not clear why only timing losses that give rise to legal risk, including the risk of being sued, should be included. |
| Suggestion | For clarity, it is not clear why only timing losses that give rise to legal risk should be included in capital calculations.  An earlier proposal related to the definition of legal risk (Article 2 §12) and the removal of the “risk of being sued”. If the indirect reference to being sued was intended as a threshold then it can be used explicitly rather than referring to legal risk. The alternative is for the firm to agree a threshold, with its home regulator, for the inclusion of timing losses in the AMA calculations. |

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| **Article 7: Scope of Operational Risk Loss** | |
| Para 2 | *An institution shall record and use, at least for AMA management purposes, the following additional items when they originate from a relevant operational risk event:*  *(a) near-misses;*  *(b) operational risk gains;*  *(c) opportunity costs/lost revenues;*  *(d) internal costs such as overtime or bonuses* |
| Comment | The threshold for collecting this event data should be a decision made by each individual firm. |
| Suggestion | This data is perceived as being useful for operational risk management. As such the data collection threshold should be a decision made by each individual firm. |

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| **Article 7: Scope of Operational Risk Loss** | |
| Para 2 | *An institution shall record and use, at least for AMA management purposes, the following additional items when they originate from a relevant operational risk event:*  *(a) near-misses;*  *(b) operational risk gains;*  *(c) opportunity costs/lost revenues;*  *(d) internal costs such as overtime or bonuses* |
| Comment | It is not clear what is meant by AMA management. |
| Suggestion | Uncertainty has been created in Article 7 §2 by the use of the term “*AMA management”*. Is this intended to be operational risk management or the team managing the AMA model?  This data is perceived as being useful for operational risk management. |

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| **Article 8: Recorded Loss of the Operational Risk items** | |
| Para 1 a | *“The whole amount of the incurred loss or expenses shall be included in the scope of operational risk loss according to Article 7(1). This includes: “*  *“all the expenses incurred as a result of the operational risk event, such as provisions, costs of settlement, amounts paid to make good the damage, penalties, interest in arrears and legal fees;”* |
| Comment | There is uncertainty as to whether the expenses are internal and external or just external. Article 7 §1b1 refers to external expenses and §1b2 cost of repair. |
| Suggestion | For clarity, a change should be made to Article 8 §1a, in particular inserting “external”. It is proposed that this paragraph should be: *all the external expenses incurred as a result of the operational risk event, such as provisions, costs of settlement, amounts paid to make good the damage, penalties, interest in arrears and legal fees;* |

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| **Article 8: Recorded Loss of the Operational Risk items** | |
| Para 1 d | *“The whole amount of the incurred loss or expenses shall be included in the scope of operational risk loss according to Article 7(1). This includes: “*  *“in case of fraud events in the credit area, the total outstanding amount at the time or after the discovery of the fraud (whole write-off amount, total credit loss) and any other related expenses, such as interest in arrears and legal fees”* |
| Comment | There is uncertainty as the “*total outstanding amount”* is not the same as the “*whole write-off, total credit loss”*. For a fraudulent mortgage the “*total outstanding amount*” might be €1,000,000, but the “write-off” might only be $200,000 due to the value of the collateral. Additionally if there is fraud, it will no longer be a “credit loss” but an “operational risk loss”. |
| Suggestion | For clarity, a change should be made to Article 8 §1d. The paragraph refers to “*total outstanding amount” and “whole write-off”.* These, figures may not be the same and could be very different. The uncertainty may be caused by the role of recoveries. For example, a fraudulent mortgage might have a “*total outstanding amount*” of €1,000,000, but the “write-off” might only be $200,000 due to the value of the collateral.  Also, if there is fraud it will no longer be a credit loss, but an operational risk loss.  Moreover, the definition of the gross loss is not clear (total outstanding amount can be LGD including off balance sheet items, write off is after collateral recoveries). |

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| **Article 8: Recorded Loss of the Operational Risk items** | |
| Para 2 | *“In case of rapidly recovered loss events, an institution may consider that only the loss net of the rapid recovery constitutes the loss to be included into the scope of operational risk loss. When the whole loss is rapidly recovered, the event is considered to be a near miss according to Article 7(2)(a) of this Regulation. For purposes of this Article 8, ‘rapidly recovered loss events’ means operational risk events that lead to losses that are recovered within five working days “* |
| Comment | It would be useful to have confirmation that rapid recoveries can be complete or partial. |
| Suggestion | For clarity, it is proposed to amend Article 8 §2 to confirm that partial recoveries are included. Many events with rapid recoveries may also have costs which cannot be recovered, for example interest arrears. The recognition of partial recoveries provides a more accurate picture of the risks involved. The paragraph could become: *In case of rapidly recovered loss events, an institution may consider that only the loss net of the rapid recovery (partial or whole) constitutes the loss to be included into the scope of operational risk loss. When the whole loss is rapidly recovered, the event is considered to be a near miss according to Article 7(2)(a) of this Regulation. For purposes of this Article 8, ‘rapidly recovered loss events (partial or whole)’ means operational risk events that lead to losses that are recovered within five working days* |

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| **Article 8: Recorded Loss of the Operational Risk items** | |
| Para 3 | *“In case of timing losses, the loss amount to be recorded comprises all the expenses incurred as a result of the operational risk event, including the correction of the financial statement, when it involves the direct relation with third parties (such as customers or authorities) or employees of the institution, and excluding the correction of the financial statement in all other cases. “* |
| Comment | As in Article 8 §a it is not clear if this refers to internal and external or just external expenses. |
| Suggestion | For clarity, it is proposed to amend Article 8 §3 to refer to “external expenses”. The paragraph would then become “*In case of timing losses, the loss amount to be recorded comprises all the external expenses incurred as a result of the operational risk event, including the correction of the financial statement, when it involves the direct relation with third parties (such as customers or authorities) or employees of the institution, and excluding the correction of the financial statement in all other cases.* |

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| **Article 8: Recorded Loss of the Operational Risk items** | |
| Para 3 | *“In case of timing losses, the loss amount to be recorded comprises all the expenses incurred as a result of the operational risk event, including the correction of the financial statement, when it involves the direct relation with third parties (such as customers or authorities) or employees of the institution, and excluding the correction of the financial statement in all other cases. “* |
| Comment | The paragraph comments on aspects of timing losses that could be confusing as it is not clear whether the second part is explanatory or an exception. |
| Suggestion | For clarity, it is proposed to amend Article 8 §3. The paragraph would then become “*In case of timing losses, the loss amount to be recorded comprises all the external expenses incurred as a result of the operational risk event, including the correction of the financial statement., ~~when it involves the direct relation with third parties (such as customers or authorities) or employees of the institution, and excluding the correction of the financial statement in all other cases.~~ In case the meaning of the sentence was to work out any exceptional case than restructure to work out that all cases without external costs are no timing losses. (“excluding the correction of the financial statement in all other cases”)* |

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| **Article 12: Independent operational risk management function** | |
| Para 2/3 | *“The competent authority shall verify that the operational risk management function is (i) empowered and supported by the management body and senior management; (ii) independent of business lines; (iii) not responsible for the audit function, taking into account the audit function’s role in challenging the operational risk framework. “* |
| Comment | With the naming of Operational Risk Management the difference between business people managing the risk and people controlling the activities is not clear. |
| Suggestion | Renaming the function to Operational Risk Controlling.  Moreover, what is the definition of exceptional transactions? |

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| **Article 17: External Loss Data** | |
| Para 1 | *“The competent authority shall verify that an institution that participates in consortia initiatives for the collection of operational risk events and losses shall provide data of comparable quality, as to scope, integrity and comprehensiveness, to the internal data standards set out in Article 16. Information obtained from consortia initiatives which have the abovementioned characteristics are an appropriate external data source for AMA capital calculation “* |
| Comment | This relates to the submission of data by individual ORX Members. Effectively this requirement is that all Members deliver to ORX data as required by the EBA for AMA firms. |
| Suggestion | Article 17 §1 needs an urgent review. Firstly, with 65 Members ORX collects data from firms in a wide variety of locations. It is not obvious that the requirements documented in this draft directive will be mirrored by the home regulators in all of these jurisdictions. The ORX dataset is richer for this diversity of location. Additionally it enables comparison with our peers and competitors, not all of whom are based in the EU.  Secondly, membership of ORX is not limited to firms that have regulatory approval to use the AMA for regulatory capital purposes. Several are on the TSA.  In summary, it is unlikely that any external database will be able to meet these requirements, which cannot have been the intention. |

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| **Article 17: External Loss Data** | |
| Para 1 | *“The competent authority shall verify that an institution that participates in consortia initiatives for the collection of operational risk events and losses shall provide data of comparable quality, as to scope, integrity and comprehensiveness, to the internal data standards set out in Article 16. Information obtained from consortia initiatives which have the abovementioned characteristics are an appropriate external data source for AMA capital calculation “* |
| Comment | This relates to the submission of data by individual ORX Members. Effectively this requirement is that Members deliver to ORX data of comparable quality that Members collect and use. This raises questions about reporting reserves & provisions as well as insurance recoveries. |
| Suggestion | Article 17 §1 needs an urgent review. Firstly, this requirement implies that all reserves & provisions that we use for internal risk management and measurement purposes must also be reported to ORX. It will be difficult to achieve comprehensive delivery of reserves & provisions without creating additional jeopardy.  Secondly, it implies that we would also be required to report all of our insurance recoveries to ORX. This information is often subject to a confidentiality agreement with our insurers. As a consequence we would not be able to report it without creating a conflict around confidentiality. |

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| **Article 17: External Loss Data** | |
| Para 1 | *“The competent authority shall verify that an institution that participates in consortia initiatives for the collection of operational risk events and losses shall provide data of comparable quality, as to scope, integrity and comprehensiveness, to the internal data standards set out in Article 16. Information obtained from consortia initiatives which have the abovementioned characteristics are an appropriate external data source for AMA capital calculation “* |
| Comment | This relates to the data supplied by ORX to its Members. Article 16 includes references to data collection thresholds. ORX has over 65 Members and there is no guarantee that all Members use the same thresholds for data collection or AMA modelling. |
| Suggestion | Article 17 §1 needs an urgent review. The ORX database is expected to meet these requirements from the perspective of data fields. However, the issue is one of thresholds. With over 65 Members the ORX Members are of varying size. The loss data collection threshold for the Global Loss Database, which is most comprehensive, has been set at €20,000. A way that the ORX Global Los database could meet the threshold requirement would be to lower its loss data to the lowest amongst its Members. This would put a particular stain upon the larger firms. |

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| **Article 21: Building the calculation data set** | |
| Para 3 | *“The competent authority shall verify that, for operational risk categories with low frequency of events, an observation period greater than five years is adopted in order to ensure sufficient data to generate reliable operational risk measures”* |
| Comment | The issue is that firms making the transition from TSA to AMA usually only have 3 years of data. So this paragraph creates a conflict. There is no cross reference to Articles 34 – 36 which discuss parallel running. |
| Suggestion | A clarification is required to Article 21 §3. This paragraph states that the minimum acceptable data history is five years. However, the target for firms entering the parallel run is to have three years of data. As a result, transitional arrangements are recommended. This might be achieved by a cross reference to a suitable paragraph in Articles 34-36.  Moreover, please provide a quantitative definition for "low frequency of events". |

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| **Art. 21(6)** | The competent authority shall verify that an institution considers applying appropriate adjustment rates on data when inflation or deflation effects are material. | Material inflation/deflation | Please provide a quantitative definition for "material". Which adjustment rate should be taken, e.g., CPI? |

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| **Article 21: Building the calculation data set** | |
| Para 5 | *The competent authority shall verify that the choice of de minimis modeling threshold does not adversely impact the accuracy of the operational risk measures. In particular, the use of de minimis modeling thresholds that are much higher than the data collection thresholds shall be limited and, when established, properly justified by sensitivity analysis at various thresholds. All operational losses above the set modelling threshold(s) shall be included in the calculation dataset and used, whatever their amounts, for generating the AMA regulatory measures.* |
| Comment | There appears to be a conflict between this paragraph and Article 21 §1, which implies that firms can construct a relevant internal loss data set for use in AMA calculations. |
| Suggestion | A clarification to Article 21 §5 is requested. There appears to be a conflict between the requirement in this paragraph to use all operational risk losses and Article 21 §1 which implies that firms can construct relevant internal loss data sets. |

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| **Article 21: Building the calculation data set** | |
| Para 7  Para 10 | *The competent authority shall verify that losses caused by a common operational risk event or by multiple events linked to a “single root-event” are grouped and entered into the calculation dataset as a single loss. The competent authority shall verify that possible exceptions are documented and properly addressed to prevent undue reduction of the capital figures*  *For purposes of this Article, ‘root event’ means the initial operational risk event from which related events have been generated and/or pertinent losses emerged* |
| Comment | Depending upon the practical interpretation of “root event”, this could amend the data collection and aggregation requirements. For example, if the “root event” refers to a process / control failure (because the firm has implicitly or explicitly decided to accept the risk) then the events would be aggregated / grouped overtime. It is not clear if the time period for grouping matches the annual accounting period or crosses accounting periods.  The practicalities may be similar to finding a root cause. |
| Suggestion | A clarification to Articles 21 §7 & 10 is requested in relation to “single root event” and “root event”. Conceptually the idea is understood and appreciated, however the concern relates to the practicality and supporting a consistent approach by firms across the EU. |

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| **Article 21: Building the calculation data set** | |
| Para 8 | "*The competent authority shall verify that an institution ensures that loss adjustments of single or linked events are not discarded from the AMA calculation data set in the case that the reference date of these adjustments falls inside the observation period and the reference date of the initial (single or root) event falls outside such a period “* |
| Comment | This paragraph is unclear what is expected. |
| Suggestion | A clarification to Article 21 §8 is requested. Does this require firms to record the date for each and every change to the loss amount when it enters the accounts?  Shall only the adjustment in terms of severity be considered for modeling or the whole single/ root's loss amount? |

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| **Art. 21(9)** | The competent authority shall verify that an institution shall be able to distinguish for each reference year included in the observation period the loss amounts pertinent to events discovered (accounted) in that year from the loss amounts pertinent to adjustments or grouping of events discovered (accounted) in previous years. | Building the calculation data set | What is the added value of this paragraph for the calculation data set? |

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| **Article 24: Building the calculation data set** | | | | | |
| Para 4 | | *“the competent authority shall verify that the institution applies appropriate techniques to avoid: (a) capping the maximum single loss;” would rule out exposure based modelling. “* | | |
| Comment | | Credit related fraud cases are limited by the exposure taken with the customer. | | |
| Suggestion | | A suggestion may be that “capping the maximum single loss, if an institution cannot provide a clear objective rationale for the existence of an upper bound (e.g. in the case of fraud events in the credit area). | | |
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| **Article 25: Expected Losses** | | | | | |
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| Comment | | | There are three commonly used definitions of expected loss:  i. Statistical e.g. 50% confidence interval  ii. Accounting  iii. Losses that are expected  The expected loss figure derived from statistical distributions will vary with the type of distribution and the data used.  The perception is that the accounting standards narrowly define expected loss, especially with regard to the creation of specific or general reserves. | | |
| Suggestion | | | A clarification is recommended to Article 25 due to the uncertainty around the meaning and intention of “Expected Loss”. The terms expected loss is regularly applied to a point on a statistical distribution, in connection with accounting reserves and losses that are expected. Which of these interpretations is intended by the EBA? There should be consistency with the term expected loss as used with Credit and Market Risks. | | |
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| **Article 25: Expected Losses** |  | | |
| Para 2 | *“The competent authority shall verify that an institution’s estimate of EL is consistent with the EL plus UL regulatory capital calculated using the operational risk measurement system. The EL estimation process shall be done by operational risk category and shall be consistent over time”*  *(“‘operational risk category’ means the level (such as the institution’s organizational unit, operational risk event type, business line) at which the institution’s operational risk measurement system generates a separate distribution for estimating potential operational losses. An operational risk category is homogeneous when its data are of the same or similar nature under the operational risk profile, independent when no form of dependence or correlation is identifiable across it, stationary when the characteristics of the data does not change when shifted in time or space;”)* | | |
| Comment | Given that capital calculations are applied to the entire bank, it is not clear why expected losses should be assessed at the level of “*operational risk category*” / Unit of Measure instead of the total firm. | | |
| Suggestion | A clarification is requested to Article 25 §2. It is not clear why the expected loss (however defined) should be assessed at the level of the “*operational risk category*”. The capital adequacy is assessed at the level of the total firm and it seems appropriate to determine the  expected loss at the same organisational level.  In case of modeling insurances, does the expected loss contain savings of this modeling, or is the expected loss without insurance reduction? | | |

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| **Art. 25(3)** | competent authority shall verify that an institution defines the EL by using statistics that are less influenced by extreme losses, such as median and trimmed mean, especially in the case of medium/heavy tailed data. The maximum offset for EL shall be bounded by the total EL and, in each operational risk category, by the pertinent EL calculated according to the institution’s operational risk measurement system applied to that category. | Expected loss | We suggest that the authority should statistically define the expected loss within the AMA model, in order to be consistent within all banks, i.e., either median or trimmed median. |

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| **Article 25: Expected Losses** | |
| Para 4 | *The competent authority shall verify that allowable offsets for EL in each operational risk category are clear capital substitutes or otherwise available to cover EL with a high degree of certainty over a one year time horizon. Where the offset is something other than provisions, its availability shall be limited to those operations with highly predictable, reasonable stable, routine losses. Because exceptional operational risk losses do not fall within EL, specific reserves for any such events that have already occurred shall not qualify as allowable EL offsets.* |
| Comment | It is not clear what is intended or meant by “clear capital substitutes or otherwise”. |
| Suggestion | A clarification is requested for Article 24 §4 on “*clear capital substitutes or otherwise”.* Expected losses for Market Risk are taken through the daily mark-to-market or mark-to-model processes. Expected Losses for Credit Risk are taken via the creation of provisions or reserves and these are taken from the P&L.  Does “*clear capital substitutes or otherwise”* refer to the P&L? |

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| **Article 25: Expected Losses** | |
| Para 4 | *The competent authority shall verify that allowable offsets for EL in each operational risk category are clear capital substitutes or otherwise available to cover EL with a high degree of certainty over a one year time horizon. Where the offset is something other than provisions, its availability shall be limited to those operations with highly predictable, reasonable stable, routine losses. Because exceptional operational risk losses do not fall within EL, specific reserves for any such events that have already occurred shall not qualify as allowable EL offsets.* |
| Comment | It is not clear what is intended or meant by “exceptional operational risk losses”. The importance of this phrase is linked to the interpretation of “Expected Loss”. |
| Suggestion | A clarification is requested in Article 24 §4 on “*exceptional operational risk loss”.* This is linked to what is meant by *e*xpected losses. |

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| Art. 30(4)+(5) | **(4)**  The competent authority shall verify that an institution takes into account the recognition of the insurer claims paying ability risk to the maximum extent, by applying appropriate haircuts in the insurance modelling methodology. This shall provide a more risk sensitive estimate of the impact of insurance and shall allow for the recognition of insurers with different claims paying ability rating above the minimum envisaged by Article 323(2) of Regulation (EU) No 575/2013.  **(5)** The competent authority shall verify that an institution ensures that the claim paying ability risk for counterparty default is assessed on the basis of the credit quality of the insurance company responsible under the given contract, even if its parent institution has a better rating or the risk is transferred to a third party. | Haircut | What is the difference between (4) and (5)? In our understanding both paragraphs consider counterparty defaults and there implication for the insurance modeling. |

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| **Article 33: Allocation Mechanism** | |
| Para 1 b | *“The competent authority shall verify that an institution’s capital allocation mechanism is consistent with the institution’s risk profile and is on forms with the overall design of the operational risk measurement system For this purpose, the competent authority shall verify the following”*  *“Capital allocation shall take into account potential internal differences in inherent risk and quality of operational risk management and internal control between the business lines/units to which capital is allocated”* |
| Comment | It is not clear if the capital allocation refers to business lines within a legal entity and /or legal entities within a jurisdiction, and/or legal entities between jurisdictions. If it is legal entities between jurisdictions then it is assumed that the host state regulator will accept the allocation algorithm accepted by the home state regulator. |
| Suggestion | A clarification is requested for Article 33 §1b on the granularity of the capital allocation. For example, does the capital allocation refer to business lines within a legal entity, legal entities within a jurisdiction or legal entities between jurisdictions? It is not clear why the regulators would focus upon the allocation of capital to business lines within a legal entity. The business lines within a legal entity are unlikely to correspond to regulatory business lines. |

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| **Art. 34 (2)** | In order to demonstrate the stability and robustness of the AMA output and to benchmark the AMA capital figure against the former approach, the competent authority in granting the permission to use the AMA shall request the institution to continue to parallel run for one year after the permission is granted. | Parallel AMA running | Before a model change is filled to the competent authority an impact study is carried out, with respect to the stability and robustness. This is done retroactively in order to judge stability and robustness of the both approaches. Therefore, a parallel run after permission is granted is not needed. We recommend running parallel before the permission but not after. |