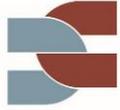


## EACB Comments

### BCBS Consultative document

# Standardised Measurement Approach for operational risk

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**Contact:**

For further information or questions on this paper, please contact:

- Mr. Volker Heegemann, Head of Department ([v.heegemann@eacb.coop](mailto:v.heegemann@eacb.coop))
- Mr. Marco Mancino, Adviser, Banking Regulation ([m.mancino@eacb.coop](mailto:m.mancino@eacb.coop))

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### ***INTRODUCTORY REMARKS***

The members of the EACB welcome the opportunity to comment on the Committee proposal on Standardised Measurement Approach (SMA) for the estimation of operational risk capital.

The proposed reform of the operational risk framework provides a realistic solution for smaller and less complex institutions. However, we question that this should lead at the same time to scrap the AMA approach. While it is understandable that the Committee sees an inherent complexity of the AMA and a wide range of internal modelling practice, we believe that the decision to withdraw all internal modelling practices does not seem an appropriate and proportionate answer and could have serious unintended consequences for risk and capital management. The committee should carefully re-evaluate the decision.

Such strong push in favour of comparability comes at the cost of a significant decrease in risk sensitivity of operational risk capital requirements for banks that are currently under the AMA, and said comparability might still not be achieved with the SMA.

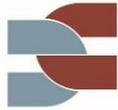
Moreover, the consultation document does not provide any indication on the timeline for the implementation period, postponing them to sometime in 2016. Clarifications in this respect are truly necessary for capital planning purposes and set up of the calculation process.

### ***GENERAL COMMENTS***

Overall the SMA does not seem too difficult for bucket 1 institutions. While being more complex than BIA, it seems manageable. It appears of comparable complexity to TSA, but at the same time introducing a sort of "simplicity premium" to be paid in terms of capital for less complex institutions.

At the same time, it should be avoided that excessive cliff effects materialise at the boundary of Buckets 1 and 2. As institutions grow and develop, their BI and the sophistication of their operational risk capability will increase, but not necessarily in an exactly parallel and continuous manner. Rather, we think institutions that have just moved into the lower end of Bucket 2 (a move which could happen passively, e.g. as a result of currency movements) would need more time to generate the necessary inputs in accordance with the minimum loss data standards set out in the CP. Accordingly, there should be either optionality on the use of LC to be extended to Bucket 2 as a whole or, as a minimum, institutions moving from Bucket 1 to Bucket 2 should retain the option not to use the LC for three complete financial years after that transition.

In addition we do not see the need for scrapping the AMA. While the SMA increases risk sensitivity for a standardised model, it certainly is less refined than the AMA. Deleting the AMA could result in a loss of risk sensitivity, important capital increases, and an overhaul of risk management processes for institutions that have carried out relevant investment efforts to implement AMA.



Many important factors that incentivize good operational risk management will become irrelevant with the proposal to repeal all AMA models, an example is the inclusion of forward looking factors such as risk mitigation and scenario analyses.

### *SPECIFIC ISSUES*

#### Definitions: Loss Component (LC)

There is no clear/homogeneous definition of what should be considered as operational loss for the Loss Component (Gross Loss, Gross Loss after recovery...). Also, we believe that amounts already insured are supposed to be deducted from the calculation.

Two additional elements are unclear with regard to the LC:

- Why small entities in the BI bucket 1 are not allowed to use the ILC, if they have the necessary capability. The option of including the loss component, and calculating the internal loss multiplier should be left at the discretion of the institution.
- Why provisions/reversal of provisions related to operational risk events are included in the Business Indicator component (BI) and at the same time they are also considered in the LC. We see that this would result into double counting and should be avoided.
- With regard to the LC, it could be clarified whether any common threshold for loss events would be established. If so, all the credit institutions would be able to use the same calculation criteria. If not, and for instance according to current COREP criteria in the EU, each institution would use and inform on loss events only regarding its internal thresholds.
- With regard to the Business Indicator (BI), knowing whether a mapping or validation process will be done would be helpful in order to obtain and validate FINREP information directly using the BIs.

We would welcome a clarification of these aspects.

#### Level of application

It should also be clarified to which level the SMA would apply in a bank with a relevant number of subsidiaries, i.e. whether the requirement of capital for operational risk at consolidated level should be the same as the sum of the requirements at each subsidiary level. Otherwise using different buckets in consolidated and subsidiary calculation capital requirement for operational risk at consolidated level will not be the same as the sum of the requirements at each subsidiary level.

In the latter case the effect between contribution on group level and local subgroup level is significant and unclear from a steering perspective.

Another example can be given by cooperative banking groups formed by a large number of small banks (e.g. falling into bucket 1) that would not have the possibility to calculate the loss component, as the latter is not envisaged for the calculation at the individual



level; this could give way to increases of capital requirement as high as 50%, passing from the sum of the individual requirements to the group level, appears then inevitable. Such an increase would also not be justified by the overall size and business model of the group, because the risk of operational losses is simply the sum of those registered at the individual bank level. In many cases these local banks are of small size, working within their local area, and with operational risks that do not appear to be correlated.

#### Use of qualitative information

We would appreciate such additional information on the expectations for the qualitative requirements to be included in SMA so that it better reflects the improvements of risk management (demonstration of usage of risk assessments for changing risk profiles, incentives for cultural changes in the bank etc.).

According to the consultative document all financial and operating lease income and expenses – including depreciation of the leased assets and gains/losses from the selling of leased assets – are netted and included in absolute value into the interest component. There is no indication whether OOI should be calculated without operating lease income and expenses to avoid double counting

#### Loss History vs Risk Profile

The simple standard formula for the loss component should guarantee that two banks with the same loss history will have the same number for their loss component. However, the focus should rather be on having institutions with the same risk profile to have the same capital requirement. The loss history is an indicator of the risk profile, but two elements need to be considered:

- Risk profiles constantly change over time. It is a very strong assumption that the operational risk profile of a bank remains constant over ten years, and it is difficult to understand why the SMA treats all losses within the previous 10 years as equally relevant to the current risk profile of an institution.
- Even if the risk profile stays the same over such a long time frame, the actual loss history is just one possible realization of this risk profile. The probabilistic nature of operational risk events has to be taken into account, especially since the sum is normally driven by very few outliers.

The introduction of a “forecast” part into the formula could significantly contribute to reduce the volatility of the SMA’s loss component. Additional focus could then be dedicated to improve the calibration to even further reduce the volatility. This can be achieved with the use of additional data sources as it was required in the AMA, e.g. external loss data and scenario analyses.