February 24, 2011

Comments on the Basel Committee's Consultative Document
Operational Risk - Supervisory Guidelines for the Advanced Measurement Approaches

Japanese Bankers Association

We, the Japanese Bankers Association, would like to express our gratitude for this opportunity to comment on the Consultative Document, *Operational Risk - Supervisory Guidelines for the Advanced Measurement Approaches*, released December 10, 2010, by the Basel Committee on Banking Supervision.

We hope that our comments below will assist the Basel Committee in its efforts to finalize rules going forward.

【General Points】

We understand that the proposed supervisory guidelines for Operational Risk Advanced Measurement Approaches (AMA) reflect progress made thus far in bank operational risk management practices from the viewpoints of governance, data requirements, and modeling. We believe that the guidelines will improve the viability of risk management and contribute to the convergence of operational risk measurement practices.

We hope that the following points will be considered for future reviews in order to approach the standards of banking practices for banks that are already implementing the Operational Risk AMA supervisory guidelines.

【Specific Points】

Data: Treatment of "net loss" (Paragraphs 24, 102)

Internal loss data can be treated in terms of either gross loss or net loss, but we request a clear definition of the term "net loss" (in quotation marks) as used in Paragraphs 24 and 102.

Paragraph 24 and 102 state that *a bank should not use "net loss" (gross loss net of insurance)* with quotation marks. Note that in Paragraph 22, the term *net loss* (no quotation marks) is defined as *the loss after taking into account the impact of recovery*. Also, in Paragraph 81, the term *net loss* (no quotation marks) is used and defined as *gross loss net of non-insurance recoveries*.

We understand the term "*net loss*" (in quotation marks) refers to gross loss net of insurance, and we think the definitions in the three uses of *net loss* that appear in Paragraphs 24 and 102, Paragraph 22, and Paragraph 81 could cause confusion for banks. We thus seek clarification regarding the differences in the different uses of the term *loss* through charts or other means.

Data: Treatment of timing losses (Paragraph 87 (a))

In Paragraph 87 (a), *timing losses* are described, in principle, as excluded from the gross loss computation. More specifically, we think operational risk losses related to previous financial statement corrections and additionally-imposed taxes often cause confusion in determinations. Thus, we seek clear examples of the determination criteria related to the portion included and the portion not included in operational risk losses in such cases.

For example, we believe the amount due to previous financial statements corrections is not included in operational risk losses, but the additional cash flows (filing-related payments caused by stakeholders, fines from authorities, etc.) are classified as operational risk losses.

Data: Treatment of rapidly recovered loss events (Paragraph 87 (b))

Paragraph 87 (b) calls events in which full loss amounts are recovered rapidly and which result in no losses occurring and that are excluded from computation of gross losses "near miss(es)." However, we are concerned that the term "rapid" has been used arbitrarily in this case. The degree of "rapid" depends on banks' own financial characteristics and risk profiles, and they should have the discretion to use their own definition in referring to those factors. Therefore, we request the Basel Committee to require documentation in its use of the term "rapid."

Modeling: Treatment of oldest loss amounts (Paragraph 191)

In the supervisory guidelines for data to calculate capital requirements, Paragraph 191 proposes appropriate adjustments when the effects of inflation or deflation are material. For example, the proposal calls for the oldest data amount to be adjusted; however, we think this should be revised to old loss amounts (Paragraph 191).

In regard to operational risk loss categories in which loss events occur infrequently, Paragraph 191 proposes, for example when extending data observation periods to 15-20 years (the minimum data observation period under the Basel II AMA is five years), applying appropriate discount adjustment rates for the oldest data amount in order to adjust for the effects of inflation or deflation.

However, because the impact of prices is continuous, we think that *the oldest data amount* portion only should not be reflected. We therefore think that the term *old loss amounts* should be used in the example given in order to clarify this intent.

Modeling: Treatment of outliers (Paragraph 192)

In Paragraph 192, in the supervisory guidelines for data to calculate capital requirement, an illustration of an *outlier* is *data that refer to abandoned business lines*. We would like, in addition to this, specific illustrations, including definitions, of outliers that have an undesirable effect on capital requirement.

Modeling: Identification of the probability distributions (Paragraph 193-209)

Paragraphs 193-209 illustrate in detail the concrete methods used in selecting and reviewing probability distributions used in modeling.

However, because some banks already use AMA, we feel that how the methods described in the Consultative Document are combined, as well as which methods are selected, should be left to the discretion of individual financial institutions. We therefore ask that an explanation of this be clearly included.