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## **Guidelines for reporting the use of the Standardised Approach for operational risk and for applying for approval to use an alternative indicator**

### **1 Introduction**

Institutions, groups of institutions and financial holding companies<sup>1</sup> within the meaning of sections 1 (1b) and 10a (2) and (3) of the Banking Act (*Kreditwesengesetz*)<sup>2</sup> are permitted to apply the Standardised Approach (TSA) to calculate the capital charge for operational risk after having reported this intention to the Federal Financial Supervisory Authority (*Bundesanstalt für  
Finanzdienstleistungsaufsicht*, hereinafter referred to as BaFin) and the Deutsche Bundesbank.

The Alternative Standardised Approach (ASA) is a special variant of the TSA in which an alternative indicator is used to calculate the capital requirement for the retail and commercial banking business lines. The application of the alternative indicator is subject to special criteria and requires the prior approval of BaFin. The rules governing the TSA, moreover, are applicable.

These instructions provide interested institutions with information on the reporting and application procedure.

### **2 Basic principles**

From 1 January 2007, institutions will be eligible to use the TSA to calculate their capital charge for operational risk instead of the Basic

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<sup>1</sup> This text will hereinafter refer only to "institutions". The provisions apply analogously for groups of institutions and financial holding groups, provided that no special arrangements are made for these institutions.

<sup>2</sup> See also sections 2 and 3 of the Solvency Regulation (*Solvabilitätsverordnung*) draft of 31 March 2006.

Indicator Approach (BIA). The use of an Advanced Measurement Approach (AMA) will be possible only from 1 January 2008.<sup>3</sup>

The requirements for using the TSA that must be fulfilled are laid down in the revised EU Directives 2000/12/EC and 93/6/EEC and have been translated into German law in section 3, chapter 3 of the Solvency Regulation as well as through the Banking Act.

– The TSA can fundamentally be applied only to an institution as a whole. There is no general provision for partial use of the TSA with the BIA; such use is permitted only on a temporary basis in justifiable exceptional cases with the prior consent of BaFin (section 277 of the Solvency Regulation). The compelling reasons for this are to be presented along with a time schedule showing when the TSA will be completely implemented.

The partial use<sup>4</sup> of the TSA with an AMA will be permitted from 1 January 2008. Institutions will need only to submit an application for approval to use an AMA. Guidelines to this effect were published and can be downloaded from the websites of BaFin and the Deutsche Bundesbank.<sup>5</sup> However, the use of the TSA must always be reported separately if it is to be used chronologically prior to an AMA and partial use of the TSA with an AMA is intended only at a later date.

An additional application for approval to use an alternative indicator is necessary for the partial use of an AMA with an ASA.

An institution using the TSA to calculate the capital charge for operational risk cannot move to the BIA without the prior consent of BaFin. An application is to be submitted for approval, giving the reasons for the intended changeover.

### **3□ Reporting of intention to use the TSA□**

Institutions intending to use the TSA to calculate the capital charge for operational risk are required to report this to BaFin (one copy) and the Deutsche Bundesbank (in duplicate) in writing in German, giving the time from which they intend to implement the TSA. The application for

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<sup>3</sup> Until 31 December 2007, institutions can use Principle I (German implementation of Basel I regulation). If, in 2007, an institution partly uses an IRB Approach or a Standardised Approach for credit risk, then a pro rata capital requirement for operational risk must also be calculated (section 339 (10) sentence 1 3rd indent of the draft Solvency Regulation).

<sup>4</sup> See section 293 of the Solvency Regulation.

<sup>5</sup> "Guidelines for applications to use an Advanced Measurement Approach for operational risk" ([http://www.bafin.de/industrie\\_ama/merkblatt.pdf](http://www.bafin.de/industrie_ama/merkblatt.pdf); [http://www.bundesbank.de/bankenaufsicht/bankenaufsicht\\_basel\\_zulassungama.en.php?print=no&](http://www.bundesbank.de/bankenaufsicht/bankenaufsicht_basel_zulassungama.en.php?print=no&)).

approval for groups of institutions or financial holding groups has to be submitted by the superordinated institution.

The report must include a legally binding signature confirming that the institution has met the requirements pursuant to sections 275 and 276 of the Solvency Regulation entitling it to use the TSA and has conducted an internal review for this purpose.

The internal assessment is to be conducted by an independent third party; the institution is also free to enlist the services of internal or external auditors. Existing current audit results may be used for the assessment.

Documentation pertaining to the internal assessment and its results is to be maintained by the institution. The documentation must indicate, in particular, the implementation of the individual requirements. Institutions may base their internal assessment and the documentation thereof on the questionnaire<sup>6</sup> that is downloadable from the websites of BaFin and the Deutsche Bundesbank. The size and complexity of the institution need to be taken into account when assessing whether an adequate risk management structure is in place and the requirements for the TSA are met.

If a subordinate institution wishes to use a TSA to calculate the capital charge, this is also to be reported by the subordinate institution even if the superordinated institution has already submitted a relevant notification regarding the calculation of the capital charge for the group. In this case, the internal review does not have to be conducted by the subsidiary itself but may, for instance, be performed by the internal audit unit of the superordinated institution in connection with the review of the TSA in the group. The documentation that needs to be kept on file at the subordinate institution can, to this extent, also refer to the superordinated institution's relevant documentation.

The report must contain not only confirmation that the requirements are met but also the following additional information.

- When the TSA will first be used.
- A note, if relevant, that an application to use an alternative indicator has already been submitted (and potentially approved) or will be submitted.
- The responsible contact person and deputy.

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<sup>6</sup> This questionnaire is not exhaustive; the requirements of the Solvency Regulation are definitive.

- In the case of groups of institutions or financial holding groups: the subordinated institutions to be included and the approach they are using. For such institutions domiciled abroad, the report should state the home country of each individual subordinated institution and the responsible national supervisor.

#### **4□ Application for approval to use an ASA□**

Pursuant to section 274 of the Solvency Regulation, an institution may use an alternative indicator instead of the relevant indicator to calculate the capital charges for the regulatory business lines of retail and commercial banking upon submitting an application and obtaining the prior consent of BaFin. Moreover, the requirements for the procedure to use the TSA pursuant to section 3 of these Guidelines have to be complied with.

The institution's application must demonstrate the institution's compliance with the following criteria.

- 1 The overwhelming part of its business is either retail banking or commercial banking business.
- 2 At least 90% of the relevant indicator originates from these regulatory business lines.
- 3 A significant proportion of its retail and/or commercial banking activities comprises loans associated with a high probability of default.
- 4 The alternative indicator provides an improved basis for assessing the operational risk.

The application is to be submitted in writing in German to BaFin (one copy) and the Deutsche Bundesbank (in duplicate) and must contain the following additional information.

- When the TSA is scheduled for initial implementation.
- The responsible contact person and deputy.

Institutions interested in using an ASA are requested to submit applications in a timely manner prior to the scheduled implementation. Institutions will be informed of the grant of approval to use an alternative indicator by means of a notice. The notice of approval may contain additional requirements.