Reserve Bank of India – Master Direction on Minimum Capital Requirements for Operational Risk

In exercise of the powers conferred by Section 35A of the Banking Regulation Act, 1949 and all other laws enabling the Reserve Bank in this regard, the Reserve Bank of India, being satisfied that it is necessary and expedient in the public interest so to do, hereby, issues the Directions hereinafter specified.

CHAPTER - I

PRELIMINARY

1. Introduction

"**Operational risk"** means the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputational risk.

2. Short title and commencement

2.1 These Directions shall be called the Reserve Bank of India (Minimum Capital Requirements for Operational Risk) Directions, 2021.

2.2 These Directions shall come into effect from April 1, 2023.

2.3 All existing approaches viz. Basic Indicator Approach (BIA), The Standardised Approach (TSA)/ Alternative Standardised Approach (ASA) and Advanced Measurement Approach (AMA) for measuring minimum operational risk capital requirements shall be replaced by **the new standardised approach** (Basel III Standardised Approach).

2.4 Until March 31, 2023, the operational risk regulatory capital requirement shall be computed in accordance with the instructions contained in paragraph 9 of *'Master Circular – Basel III Capital Regulations'* issued vide circular DBR.No.BP.BC.1/21.06.201/2015-16 dated July 1, 2015.

3. Applicability

3.1 The provisions of these Directions shall apply to all Commercial Banks (excluding Local Area Banks, Payments Banks, Regional Rural Banks, and Small Finance Banks).

3.2 The scope of application shall be in accordance with the paragraph 3 of *'Master Circular – Basel III Capital Regulations'* issued vide circular DBR.No.BP.BC.1/21.06.201/2015-16 dated July 1, 2015, as amended from time to time.

CHAPTER -II

BASEL III STANDARDISED APPROACH (BASEL III SA)

4. Components of Basel III SA

4.1 Basel III SA calculation methodology is based on the following components:

(i) the **Business Indicator (BI)**, which is a financial-statement-based proxy for operational risk;

(ii) the **Business Indicator Component (BIC)**, which is calculated by multiplying the BI by a set of marginal coefficients (α_i); and

(iii) the **Internal Loss Multiplier (ILM),** which is a scaling factor that is based on a bank's average historical losses and the BIC.

4.2 Business Indicator (BI)

The BI shall be computed as the summation of the following three components,

$$BI = ILDC+SC+FC$$

Where,

ILDC is the Interest, Lease and Dividend Component;
SC is the Services Component; and
FC is the Financial Component.

4.3 The ILDC, SC and FC shall be computed as per the formula below, where a bar above a term indicates that it is calculated as the average over three years: t, t-1 and t-2, and:

- $ILDC = Min[\overline{Abs(Interest\ Income - Interest\ Expense)}; 2.25\% \times \overline{Interest\ Earning\ Assets}] + \overline{Dividend\ Income}$
- $SC = Max[\overline{Other\ Operating\ Income}; \overline{Other\ Operating\ Expense}] + Max\ [\overline{Fee\ Income}; \overline{Fee\ Expense}]$
- $FC = \overline{Abs\ (Net\ P\&L\ Trading\ Book)} + \overline{Abs\ (Net\ P\&L\ banking\ Book)}$

Where,

Max=Maximum,

Min=Minimum, and

Abs= Absolute value of sub-components irrespective of their signs (+ or -)

The definitions for each of the components of the BI are provided in **Annex 1**.

4.4 Business Indicator Component (BIC)

The BIC shall be calculated by multiplying the BI with the marginal coefficients (α_i), which increase with the size of the BI as shown in Table 1 below.

BI ranges and marginal coefficients		**Table 1**
Bucket	**BI Range (in ₹ Crore)**	**BI Marginal Coefficients (α_i)**
1	≤8000	12%
2	8000<BI≤240000	15%
3	>240000	18%

4.5 Internal Loss Multiplier (ILM)

4.5.1 A bank's internal operational risk loss experience affects the calculation of operational risk capital through the ILM. The ILM shall be calculated as given below,

$$ILM = ln\left\{\exp(1) - 1 + \left[\frac{LC}{BIC}\right]^{0.8}\right\}$$

Where the Loss Component (LC) is equal to 15 times average annual operational risk losses.

4.5.2 The calculation of average losses in the LC shall be based on 10 years of high-quality operational risk annual loss data. However, banks that do not have 10 years of high-quality loss data but have five years and above of high-quality loss data shall make use of such available high-quality loss data of five years and above to calculate the LC.

4.6 Operational Risk Capital (ORC)

4.6.1 (i) **For banks in bucket 1, and (ii) For banks in buckets 2 & 3 that do not have 5 years of high-quality operational risk annual loss data**

The ORC requirement shall be equal to BIC, as defined in section 4.4 of this Chapter:

$$\boxed{ORC = BIC}$$

The Reserve Bank (Department of Supervision) may however require banks in buckets 2 & 3 to calculate ORC requirement using fewer than five years of losses if the ILM is greater than 1 and the supervisor believes that the losses are representative of the bank's operational risk exposure. In such cases, ORC requirement shall be calculated in accordance with section 4.6.2.

4.6.2 For banks in buckets 2 & 3 having 5 years and above of high-quality operational risk annual loss data

The ORC requirement shall be calculated by multiplying the BIC as defined in section 4.4 of this Chapter by the ILM as given in section 4.5 of this Chapter:

$$\boxed{ORC = BIC \times ILM}$$

4.7 Risk-weighted assets

The risk-weighted assets (RWA) for operational risk shall be calculated by multiplying the ORC by 12.5.

5. Application of Basel III SA within a banking group

5.1 At the consolidated level, the Basel III SA calculations shall be based on fully consolidated BI figures, which net all the intragroup income and expenses.

5.2 The calculations at a sub-consolidated level shall be based on BI figures for the banks consolidated at that particular sub-level.

5.3 The calculations at the subsidiary level shall be based on BI figures from the subsidiary.

5.4 A sub-consolidated bank or a subsidiary bank shall use only the losses it has incurred at that particular sub-level.

6. Loss data identification, collection, and treatment for banks in buckets 2 & 3

6.1 Identification and collection of the operational risk loss data shall be guided by the criteria provided in point no.4 of **Technical Guidance Note, Annex 2**.

6.2 Banks which do not meet the five years of high quality loss data criteria shall be required to hold capital at a minimum equal to the BIC. The Reserve Bank (Department of Supervision) may however require the bank to apply an ILM which is greater than 1 to calculate the capital requirements if the bank's ILM is greater than 1 and supervisors believe the losses are representative of the bank's operational risk exposure. The exclusion of internal loss data due to non-compliance with the loss data criteria, and the application of any resulting multipliers, shall be publicly disclosed in accordance with the Pillar 3 requirements.

6.3 Inclusion of losses related to mergers and acquisitions and exclusion of losses shall be guided by the criteria provided in point no. 4.3 & 4.4 resp. of **Technical Guidance Note, Annex 2**.

7. Inclusion of BI items related to mergers and acquisitions

BI items from merged entities or acquired businesses shall be included in the calculation of ORC immediately after the merger/acquisition and shall be disclosed under Pillar 3.

8. Exclusions of divested activities from the BI

Divested activities shall be excluded from the calculation of the BI amount used for the calculation of ORC only after the Reserve Bank's (Department of Supervision's) approval. Such exclusions shall be disclosed under Pillar 3.

9. Disclosure

9.1 Each of the BI sub-items for each of the three years of the BI component calculation window shall be disclosed in accordance with the Pillar 3 requirements.

9.2 For banks in buckets 2 & 3, annual loss data for each of the last ten years or each of the years with available annual loss data shall be disclosed in accordance with the Pillar 3 requirements. Loss data shall be reported net of recoveries, both before and after loss exclusions.

9.3 The disclosures on general qualitative information on a bank's operational risk framework and quantitative information on BI sub-items and loss data shall be made as prescribed in **Annex 3**.

CHAPTER -III
REPEAL

10. With the issue of these Directions, the instructions / guidelines contained in the following circulars issued by the Reserve Bank stand repealed:

Sr No	Title	Circular number and date
1.	Paragraph 3. S. No. b. & c. of Introduction of Advanced Approaches of Basel II Framework in India – Time Schedule	DBOD.BP.BC.No.23/21.06.001/2009-10 dated July 7, 2009
2.	Implementation of The Standardised Approach (TSA) for Calculation of Capital Charge for Operational Risk	DBOD.No.BP.BC.84/21.06.001/2009-10 dated March 31, 2010

3.	Implementation of the Advanced Measurement Approach (AMA) for Calculation of Capital Charge for Operational Risk	DBOD.No.BP.BC.88/21.06.014/2010-11 dated April 27, 2011
4.	Revisions to Basel II-Advanced Approaches of Operational Risk-TSA and AMA	DBOD.No.BP.BC.43/21.06.017/2014-15 dated October 16, 2014
5.	Paragraph 9 on 'Capital charge for Operational Risk' and Table-DF-8 on 'Operational Risk' of Master Circular- Basel III Capital Regulations	DBR.No.BP.BC.1/21.06.201/2015-16 dated July 1, 2015

Annex 1

Definitions of Business Indicator items

BI Component	P&L or balance sheet items	Description	Typical sub-items	Indicative Mapping to specific line items/schedules in the Balance Sheet and/or P&L Account
Interest, lease and dividend	Interest income	Interest income from all financial assets and other interest income (includes interest income from financial and operating leases and profits from leased assets)	• Interest income from loans and advances, assets available for sale, assets held to maturity, trading assets, financial leases and operational leases • Interest income from hedge accounting derivatives • Other interest income • Profits from leased assets	Schedule 13-Interest Earned
	Interest expenses	Interest expenses from all financial liabilities and other interest expenses (includes interest expense from financial and operating leases, losses, depreciation and impairment of, and losses from, operating leased assets)	• Interest expenses from deposits, debt securities issued, financial leases, and operating leases • Interest expenses from hedge accounting derivatives • Other interest expenses • Losses from leased assets • Depreciation and impairment of operating leased assets	Schedule 15-Interest expended
	Interest earning assets (balance sheet item)	Total gross outstanding loans, advances, interest bearing securities including government bonds, and lease assets (i.e. all outstanding credit obligations in the balance sheet, including credit obligations on non-accrued status e.g.		

		non-performing assets shall be included in interest earning assets) measured at the end of each financial year.		
	Dividend income	Dividend income from investments in stocks and funds not consolidated in the bank’s financial statements, including dividend income from non-consolidated subsidiaries, associates and joint ventures.		Schedule 14 (VI)- Income earned by way of dividend etc. from subsidiaries, companies, joint ventures abroad/in India
Services	Fee and commission income	Income received from providing advice and services. Includes income received by the bank as an outsourcer of financial services.	Fee and commission income from: • Securities (issuance, origination, reception, transmission, execution of orders on behalf of customers) • Clearing and settlement; Asset management; Custody; Fiduciary transactions; Payment services; Structured finance; Servicing of securitisations; Loan commitments and guarantees given; and foreign transactions	Schedule 14- (I) Other Income- Commission, Exchange & Brokerage
	Fee and commission expenses	Expenses paid for receiving advice and services. Includes outsourcing fees paid by the bank for the supply of financial services, but not outsourcing fees paid for the supply of non-financial services (e.g. logistical, IT, human resources)	Fee and commission expenses from: • Clearing and settlement; Custody; Servicing of securitisations; Loan commitments and guarantees received; and Foreign transactions	Relevant expenses incorporated in Schedule 16- Operating Expenses

	Other operating income	Income from ordinary banking operations not included in other BI items but of similar nature (income from operating leases shall be excluded)	• Rental income from investment properties • Gains from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations	Schedule 14- (IV) Profit on sale of land, buildings & other assets (VII) Miscellaneous income (excluding profit (loss) on financial assets and liabilities in the banking book and items given in the Note below this Table)
	Other operating expenses	Expenses and losses from ordinary banking operations not included in other BI items but of similar nature and from operational loss events (expenses from operating leases shall be excluded)	• Losses from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations • Losses incurred as a consequence of operational loss events (e.g. fines, penalties, settlements, replacement cost of damaged assets), which have not been provisioned/reserved for in previous years • Expenses related to establishing provisions/reserves for operational loss events	1. Schedule 14- (IV) Loss on sale of land, building & other assets) 2. Schedule 16-Operating Expenses (excluding the items included in "Fee and commission expenses" and items given in the Note below this Table)
Financial	Net profit (loss) on the trading book	Net profit/loss on the trading book comprises of net profit/loss on the following items, • Securities included under the Held for Trading category • Securities included under the Available for Sale category • Open gold position limits • Open foreign exchange position limits • Trading positions in derivatives, and • Derivatives entered into for hedging trading book exposures.		Schedule 14 – (II) Profit (loss) on sale of investments (III) Profit (loss) on revaluation of investments, excluding profit (loss) on sale of investments in HTM category (V) Profit (loss) on exchange transactions

	Net profit (loss) on the banking book	Net profit/loss on the banking book comprises of net profit/loss on the assets and liabilities, which are contracted basically on account of relationship or for steady income and statutory obligations and are generally held till maturity. This excludes the items covered under trading book as specified above.	Schedule 14 – (II) Profit (loss) on sale of investments in HTM category (VII) Profit (loss) on financial assets and liabilities in the banking book & included in Schedule 14 (VII)

Note: The following P&L items do not contribute to any of the items of the BI:

- Income and expenses from insurance or reinsurance businesses
- Premiums paid and reimbursements/payments received from insurance or reinsurance policies purchased
- Administrative expenses, including staff expenses, outsourcing fees paid for the supply of nonfinancial services (e.g. logistical, IT, human resources), and other administrative expenses (e.g. IT, utilities, telephone, travel, office supplies, postage)
- Recovery of administrative expenses including recovery of payments on behalf of customers (e.g. taxes debited to customers)
- Expenses of premises and fixed assets (except when these expenses result from operational loss events)
- Depreciation/amortisation of tangible and intangible assets (except depreciation related to operating lease assets, which shall be included in financial and operating lease expenses)
- Provisions/reversal of provisions (e.g. on pensions, commitments and guarantees given) except for provisions related to operational loss events
- Expenses due to share capital repayable on demand
- Impairment/reversal of impairment (e.g. on financial assets, non-financial assets, investments in subsidiaries, joint ventures and associates)
- Changes in goodwill recognised in profit or loss
- Corporate income tax (tax based on profits including current tax and deferred).

Annex 2

Technical Guidance Note on Minimum Capital Requirements for Operational Risk

1. What are the components of legal risk?

Legal risk shall include, but not limited to, exposure to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements.

2. How items of BI-sub components shall be averaged over three years?

The absolute value of net items (e.g. interest income – interest expense) shall be calculated first year by year. Only after this year by year calculation should the average of the three years be calculated. This has been explained in the illustration given below

Illustration-I

Suppose, for a particular bank the values of items of BI sub-components for three years period are as given below:

(Amount ₹ in crore)

Year	Interest Income	Interest Expense	Abs (Interest Income-Interest Expense)
Jan 2018- Dec 2018	3,000	3,500	500
Jan 2019- Dec 2019	3,500	3,200	300
Jan 2020- Dec 2020	4,000	3,600	400

The average of absolute value of the above item of BI sub-component shall be ₹ 400 crore ((500+300+400)/3)

3. How the BIC shall be calculated?

For banks in the first bucket (i.e. with a BI less than or equal to ₹8,000 Crore), the BIC shall be equal to BI x 12%. The marginal increase in the BIC resulting from a one-unit increase in the BI is 12% in bucket 1, 15% in bucket 2 and 18% in bucket 3. This has been explained in the illustration given below

Illustration-II

If for a particular bank, BI = ₹3,50,000 crore, then BIC shall be calculated as given below

BIC = (8,000 x 12%) + (2,40,000-8,000) x 15% + (3,50,000-2,40,000) x 18%

= ₹ 55,560 Crore.

4. What shall be the criteria for identification and collection of the operational risk loss data?

There shall be general criteria and specific criteria for identification and collection of the operational risk loss data as delineated below

4.1 General criteria

(a) Internal loss data are most relevant when clearly linked to a bank's current business activities, risk management procedures, and technological processes. Therefore, a bank shall document procedures and processes for the identification, collection, and treatment of internal loss data. Such procedures and processes shall be subjected to internal/external validation, and independent reviews, by internal and/or external auditors as per the board approved policy of the bank.

(b) For risk management purposes, and to assist in supervisory validation and/or review, Reserve Bank (Department of Supervision) may request a bank to map its historical internal loss data into the relevant Level 1 supervisory categories as defined in **Annex 4** and to provide this data to Reserve Bank (Department of Supervision). The criteria for allocating losses to the specified event types shall be documented.

(c) A bank's internal loss data shall be comprehensive and capture all material activities and exposures from all appropriate subsystems and geographic locations.

The minimum threshold for including a loss event in the data set is set at ₹1,00,000[1]. For operational losses from outsourced activities, the financial impacts of events that the bank is responsible for shall be included in the dataset as operational losses. The financial impacts of events that are paid by the outsourcer (rather than by the bank) are not operational losses of the bank and therefore shall not be included in the dataset as operational losses.

(d) In addition to the information on gross loss amounts, the bank shall collect information about the reference dates of operational risk events, including the date when the event happened ("date of occurrence"), where available; the date on which the bank became aware of the event ("date of discovery"); and the date (or dates) when a loss event results in a loss, reserve or provision against a loss being recognised in the bank's profit and loss (P&L) accounts ("date of accounting"). The bank shall also collect information on recoveries of gross loss amounts as well as descriptive information about the drivers or causes of the loss event[2]. The details of any descriptive information shall be commensurate with the size of the gross loss amount.

(e) While building a loss data set from a foreign subsidiary of a bank, loss impacts denominated in a foreign currency shall be converted using the same exchange rate that is used to convert them in the bank's financial statements of the period in which the loss impacts are accounted for.

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[1] Some operational loss events result in multiple accounting impacts, which can be loss impacts or recoveries. To determine whether an operational loss event should be included in the Loss Component calculation dataset, the net loss amount of the event shall be calculated by summing all of the event's loss impacts inside the ten-year calculation window and subtracting all recoveries inside the ten-year calculation window. The accounting date of the impacts is used to determine whether they are inside the ten year calculation window. If the event's net total loss amount is equal to or above ₹1,00,000, the loss event shall be included in the calculation dataset. Note that a loss event may not result in a net loss amount above ₹1,00,000 in any individual year and still have to be included in the loss dataset as long as the cumulative impact of the loss event in the ten year window is equal to or above ₹1,00,000.

For example, for a ten year period (2012 to 2021) window, suppose one loss event results in a loss impact of ₹96,000 in 2012 and ₹7,000 in 2013. This loss event shall be included in the calculation dataset because its total impact inside the calculation window is ₹1,03,000. On the other hand, a loss event that resulted in a loss impact of ₹10,00,000 in 2010 (outside of the ten year window), a loss impact of ₹300,000 in 2013 (inside the calculation window), and a recovery of ₹5,00,000 in 2015 (inside the calculation window) shall not be included in the loss dataset.

[2] Tax effects (e.g. reductions in corporate income tax liability due to operational losses) shall not be treated as recoveries.

(f) Operational loss events related to credit risk and that are accounted for in credit RWA shall not be included in the operational loss data set. Operational loss events that relate to credit risk but are not accounted for in credit RWA shall be included in the operational loss data set.

(g) Operational risk losses related to market risk shall be included in the operational loss data set.

(h) Banks shall have processes to independently review the comprehensiveness and accuracy of loss data.

4.2 Specific criteria on loss data identification, collection and treatment

4.2.1 **Building loss data set**

Building an acceptable loss data set from the available internal data requires that the bank develops policies and procedures to address several features, including gross loss definition, reference date and grouped losses.

4.2.2 **Gross loss, net loss, and recovery definitions**

4.2.2.1 Gross loss is a loss before recoveries of any type. Net loss is defined as the loss after taking into account the impact of recoveries. The recovery is an independent occurrence, related to the original loss event, separate in time, in which funds or inflows of economic benefits are received from a third party.[3]

4.2.2.2 Banks shall identify the gross loss amounts, non-insurance recoveries, and insurance recoveries for all operational loss events. Banks shall use losses net of recoveries (including insurance recoveries) in the loss dataset. However, recoveries can be used to reduce losses only after the bank receives payment. Receivables do not count as recoveries. Verification of payments received to net losses shall be provided to the Reserve Bank upon request.

4.2.2.3 The following items shall be included in the gross loss computation of the loss data set:

[3] Examples of recoveries are payments received from insurers, repayments received from perpetrators of fraud, and recoveries of misdirected transfers.

(a) Direct charges, including impairments and settlements, to the bank's P&L accounts and write-downs due to the operational risk event;

(b) Costs incurred as a consequence of the event including external expenses with a direct link to the operational risk event (e.g. legal expenses directly related to the event and fees paid to advisors, attorneys or suppliers) and costs of repair or replacement, incurred to restore the position that was prevailing before the operational risk event;

(c) Provisions[4] or reserves accounted for in the P&L against the potential operational loss impact;

(d) Losses stemming from operational risk events with a definitive financial impact, which are temporarily booked in transitory and/or suspense accounts and are not yet reflected in the P&L ("pending losses"). Material pending losses shall be included in the loss data set within a time period commensurate with the size and age of the pending item; and

(e) Negative economic impacts booked in a financial accounting period, due to operational risk events impacting the cash flows or financial statements of previous financial accounting periods ("timing losses").[5] Material "timing losses" shall be included in the loss data set when they are due to operational risk events that span more than one financial accounting period and give rise to legal risk.

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[4] When a bank makes a provision due to an operational loss event, such provision shall be considered as an operational loss immediately. When a charge-off (such as a settlement) eventually takes place later, only the difference between the initial provision and the charge-off (if any) shall be added to the operational loss calculation. For example, if a bank makes a provision of ₹1 crore for a legal event in 2018 and then settles the legal event for ₹1.20 crore in 2019, it shall include the provision of ₹1 crore in the operational loss data of 2018 and the additional ₹20 lakh in the operational loss data of 2019 (equal to the ₹1.20 crore settlement in 2019 minus the ₹1 crore provision in 2018). There shall be no double counting of the same financial impacts in the calculation of operational losses.

[5] Timing impacts typically relate to the occurrence of operational risk events that result in the temporary distortion of an institution's financial accounts (e.g. revenue overstatement, accounting errors and mark-to-market errors). While these events do not represent a true financial impact on the institution (net impact over time is zero), if the error continues across more than one financial accounting period, it may represent a material misrepresentation of the institution's financial statements.
For example, when a bank refunds a client that was overbilled due to an operational failure, if the refund is provided in the same financial accounting period as the overbilling took place and thus no misrepresentation of the institution's financial statements occurs, there is no operational loss. If the refund occurs in a subsequent financial accounting period to the overbilling, it is a timing loss; any operational loss event that exceeds the threshold of ₹1,00,000 shall be included in the loss dataset. In this case, the prior overbilling shall not be considered as a recovery.

4.2.2.4 The following items shall be excluded from the gross loss computation of the loss data set:

(a) Costs of general maintenance contracts on property, plant or equipment;

(b) Internal or external expenditures to enhance the business after the operational risk losses: upgrades, improvements, risk assessment initiatives and enhancements; and

(c) Insurance premiums.

4.2.2.5 Banks shall use the date of accounting for building the loss data set. Banks shall use a date no later than the date of accounting for including losses related to legal events in the loss data set. For legal loss events, the date of accounting is the date when a legal reserve is established for the probable estimated loss in the P&L.

4.2.2.6 Losses caused by a common operational risk event[6] or by related operational risk events[7] over time, but posted to the accounts over several years, shall be allocated to the corresponding years of the loss database, in line with their accounting treatment.

4.3 Inclusion of losses related to mergers and acquisitions

Operational risk losses of merged entities or acquired businesses over the ten years period prior to the acquisition /merger shall be included in the calculation of ORC immediately after the merger/acquisition and shall be disclosed under Pillar 3.

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[6] All operational losses caused by a common underlying trigger or root cause shall be grouped into one operational loss event in a bank's operational loss event dataset. Two examples of losses with a common underlying trigger or root cause, which should be grouped into a single loss event:

(i) A natural disaster causes losses in multiple locations and/or across an extended time period.

(ii) A breach of a bank's information security results in the disclosure of confidential customer information. As a result, multiple customers incur fraud-related losses that the bank must reimburse. This is sometimes accompanied by remediation expenses such as credit card re-issue or credit history monitoring services.

Banks shall have a clear, well-documented policy for determining the criteria for multiple losses to be grouped into an operational loss event. In addition, processes shall be in place to ensure that there is a firm-wide understanding of the loss event grouping policy, that there is appropriate sharing of loss event data across businesses to implement the policy effectively and that there are adequate controls (including independent review) to assess ongoing compliance with the policy.

[7] Same as mentioned in footnote no. 6 above

4.4 Exclusion of losses

4.4.1 Banks may request the Reserve Bank (Department of Supervision) to exclude[8] certain operational loss events that are no longer relevant to their risk profiles. The exclusion of internal loss events shall be rare and supported by strong justification. In evaluating the relevance of operational loss events to the bank's risk profile, the Reserve Bank (Department of Supervision) will evaluate whether the cause of the loss event could occur in other areas of the bank's operations. Taking settled legal exposures and divested businesses as examples, the Reserve Bank expects the bank's analysis to demonstrate that there is no similar or residual legal exposure and that the excluded loss experience has no relevance to other continuing activities or products.

4.4.2 Exclusion of losses shall be subject to a materiality threshold (for example, the excluded loss event shall be greater than 5% of the bank's average losses). In addition, losses can only be excluded after being included in the bank's operational risk loss database for a minimum period (for example, three years). Losses related to divested activities shall not be subjected to such minimum operational risk loss database retention period.

4.4.3 Losses shall be excluded from the calculation of the ILM used for the calculation of ORC only after the Reserve Bank's (Department of Supervision's) approval. The total loss amount and number of exclusions shall be disclosed under Pillar 3 with appropriate narratives, including total loss amount and number of exclusions.

[8] Banks may suffer operational risk losses related to the reform of benchmark reference rates, particularly if they do not adequately prepare for the transition to the new rates. For example, losses may be incurred over an extended period of time if banks fail to identify and remediate relevant legacy contracts prior to the discontinuation of a benchmark rate. To minimise the risk of operational risk losses, banks should consider the effects of benchmark rate reform on their businesses in a timely manner and make the necessary preparations for the transition to the alternative rates. In doing so, they should maintain a close dialogue with the Reserve Bank (Department of Supervision) regarding their plans and transition progress, including any identified impediments.

Annex 3

Revised disclosure requirements for operational risk

Template ORA: General Qualitative information on a bank's operational risk framework

Frequency of disclosure- Quarterly

Banks shall describe:

1 Their policies, frameworks and guidelines for the management of operational risk.

2 The structure and organisation of their operational risk management and control function.

3 Their operational risk measurement system (i.e. the systems and data used to measure operational risk in order to estimate the operational risk capital charge).

4 The scope and main context of their reporting framework on operational risk to executive management and to the board of directors.

5 The risk mitigation and risk transfer used in the management of operational risk. This includes mitigation by policy (such as the policies on risk culture, risk appetite, and outsourcing), by divesting from high-risk businesses, and by the establishment of controls. The remaining exposure can then be absorbed by the bank or transferred. For instance, the impact of operational losses can be mitigated with insurance.

Template OR 1: Historical losses

Frequency of disclosure: Annual

Minimum threshold for collection of loss data: ₹1,00,000

Banks are expected to supplement the template with narrative commentary explaining the rationale in aggregate, for new loss exclusions since the previous disclosure. Banks should disclose any other material information, in aggregate, that would help inform users as to its historical losses or its recoveries, with the exception of confidential and proprietary information, including information about legal reserves.

		a	b	c	d	e	f	g	h	i	j	K
		T	**T-1**	**T-2**	**T-3**	**T-4**	**T-5**	**T-6**	**T-7**	**T-8**	**T-9**	**Ten year average**
1	Total amount of operational losses net of recoveries (no exclusion)											
2	Total number of operational risk losses											
3	Total amount of excluded operational risk losses											
4	Total number of exclusions											
5	Total amount of operational losses net of recoveries and net of excluded losses											

For columns a to j, T denotes the end of the annual reporting period, T–1 the previous year-end, etc. Column (k) refers to the average annual losses net of recoveries and excluded losses over 10 years.

Loss amounts and the associated recoveries should be reported in the year in which they were recorded in financial statements.

Template OR 2: Business Indicator and Sub components

Frequency of disclosure: Quarterly

		a	b	c
	Business Indicator (BI) and its sub components	**T**	**T-1**	**T-2**
1	Interest, lease, and dividend component			
1a	Interest and lease income			
1b	Interest and lease expenses			
1c	Interest earning assets			
1d	Dividend Income			
2	Services component			
2a	Fee and commission income			
2b	Fee and commission expense			
2c	Other operating income			
2d	Other operating expense			
3	Financial Component			
3a	Net P&L on the trading book			
3b	Net P&L on the banking book			
4	BI			
5	Business Indicator Components (BIC)			

Disclosure on the BI

6a	BI gross of excluded divested activities	
6b	Reduction in BI due to excluded divested activities	

Template OR3: Minimum required operational risk capital

Frequency of disclosure: Quarterly

		a
1	Business indicator component (BIC)	
2	Internal loss multiplier (ILM)	
3	Minimum required operational risk capital (ORC)	
4	Operational risk RWA	

Annex 4

Detail loss event type classification

Event-type category (Level1)	Definition	Categories (Level 2)	Activity examples (Level 3)
Internal fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, excluding diversity/ discrimination events, which involves at least one internal party	Unauthorised activity	Transactions not reported (intentional) Transaction type unauthorised (with monetary loss) Mismarking of position (intentional)
		Theft and fraud	Fraud / credit fraud / worthless deposits Theft / extortion /embezzlement / robbery Misappropriation of assets Malicious destruction of assets Forgery Check kiting Smuggling Account takeover / impersonation etc. Tax non-compliance / evasion (wilful) Bribes / kickbacks Insider trading (not on firm's account)
External fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent the law, by a third party	Theft and fraud	Theft / robbery Forgery Check kiting
		Systems security	Hacking damage Theft of information (with monetary loss)

Employment practices and workplace safety	Losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims, or from diversity / discrimination events	Employee relations	Compensation, benefit, termination issues Organised labour activity
		Safe environment	General liability (slip and fall etc.) Employee health and safety rules events Workers compensation
		Diversity and discrimination	All discrimination types
Clients, products and business practices	Losses arising from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product.	Suitability, disclosure and fiduciary	Fiduciary breaches / guideline violations Suitability / disclosure issues (know-your-customer etc.) Retail customer disclosure violations Breach of privacy Aggressive sales Account churning Misuse of confidential information Lender liability
		Improper business or market practices	Antitrust Improper trade / market practices Market manipulation Insider trading (on firm's account) Unlicensed activity Money laundering
		Product flaws	Product defects (unauthorised etc.) Model errors
		Selection, sponsorship and exposure	Failure to investigate client per guidelines Exceeding client exposure limits

		Advisory Activities	Disputes over performance of advisory activities
Damage to physical assets	Losses arising from loss or damage to physical assets from natural disaster or other events	Disasters and other events	Natural disaster losses Human losses from external sources (terrorism, vandalism)
Business disruption and system failures	Losses arising from disruption of business or system failures	Systems	Hardware Software Telecommunications Utility outage / disruptions
Execution, delivery and process management	Losses from failed transaction processing or process management, from relations with trade counterparties and vendors	Transaction capture, execution and maintenance	Miscommunication Data entry, maintenance or loading error Missed deadline or responsibility Model / system misoperation Accounting error / entity attribution error Other task misperformance Delivery failure Collateral management failure Reference data maintenance
		Monitoring and reporting	Failed mandatory reporting obligation Inaccurate external report (loss incurred)
		Customer intake and documentation	Client permissions / disclaimers missing Legal documents missing / incomplete
		Customer / client account management	Unapproved access given to accounts Incorrect client records (loss incurred) Negligent loss or damage of client assets

		Trade Counterparties	Non-client counterparty misperformance Miscellaneous non-client counterparty disputes
		Vendors and Suppliers	Outsourcing Vendor disputes