

October 14, 2005

To

The Chairman
All Scheduled Commercial Banks

Dear Sir,

Guidance Note on Management of Operational Risk

1. As you are aware, The Basel Committee on Banking Supervision (BCBS) released the "International Convergence of Capital Measurement and Capital Standards – A Revised Framework" in June 2004. In terms of the draft guidelines on implementation of the New Capital Adequacy Framework issued on February 15, 2005, banks in India are required to maintain capital for operational risk as per the Basic Indicator Approach. As a step towards enhancing and fine tuning management of operational risk, a draft guidance note based on the inputs of the Working Group, consisting of senior officials from select banks, were issued to banks vide DBOD.No.BP.1365/21.04.118/2004-05 dated March 11, 2005.

2. Comments on the Guidance Note were received from a wide spectrum of banks. The draft Guidance Note has been revised in the light of the feedback received and the revised Guidance Note is now placed on the website of RBI (<http://www.rbi.org.in>).

3. Banks may use this Guidance Note for upgrading their risk management systems. The design of risk management framework should be oriented towards the banks' own requirements dictated by the size and complexity of business, risk philosophy, market perception and the expected level of capital. The systems, procedures and tools prescribed in the Guidance Note for effective Management of Operational Risk may therefore be treated as indicative. The risk management systems in the banks should, however, be adaptable to changes in business, size, the market dynamics and introduction of innovative products by banks in future.

4. Please acknowledge receipt

Yours faithfully,

(Anand Sinha)
Chief General Manager-in-Charge