



भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA
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October 16, 2014

The Chairman and Managing Director /
Chief Executive Officer of
All Scheduled Commercial Banks
(Excluding RRBs and Local Area Banks)

Dear Sir,

Revisions to Basel II-Advanced Approaches of Operational Risk-TSA and AMA

Please refer to the Reserve Bank Guidelines on Basel II-Advanced Approaches of Operational Risk as contained in circulars dated March 31, 2010 on 'Implementation of The Standardised Approach (TSA) for Calculation of Capital Charge for Operational Risk' and circular dated April 27, 2011 on 'Implementation of the Advanced Measurement Approach (AMA) for Calculation of Capital Charge for Operational Risk'.

2. A comparison of the Reserve Bank guidelines on Operational Risk with the Basel Guidelines was taken by RBI recently based on which, it has been decided to carry out certain revisions/additions to the guidelines, as detailed in **Annex** of this circular. The revisions/additions may be read in conjunction with the existing guidelines contained in the TSA/AMA circulars as indicated there against.

3. All other guidelines on Basel II-Operational Risk as contained in the circulars mentioned in Para I above as well as in the Para 9 (BIA) of Master Circulars on Implementation of New Capital Adequacy Framework (NCAF) and Basel III Capital Regulations dated July 1, 2014 (updated every year) remain unchanged.

Yours faithfully,

(Sudarshan Sen)

Chief General Manager-in-Charge

Department of Banking Operations and Development, Central Office, 12th floor, Central Office
Building, Shahid Bhagat Singh Marg, Mumbai - 400001

A) Revisions / Changes in TSA Guidelines dated March 31, 2010

1. Para 1.6: Parallel Run is added as follows:

1.6. Parallel Run

1.6.1. RBI would initially accord a provisional approval to the bank to migrate to TSA and the bank having such an approval will be required to perform parallel calculation of capital as per BIA in addition to calculations as per TSA.

1.6.2. During the parallel run, RBI will continue to evaluate the readiness of the bank to adopt the TSA in order to reach a decision, on whether to grant or withhold the final approval for the bank to adopt the TSA. RBI may withhold such approval if, during the parallel run, it becomes aware of information that materially affects its assessment of the readiness of the bank or if any outstanding issue identified prior to the start of the parallel run has not been addressed.

1.6.3. RBI will recognise a parallel run only if it is based on an operational risk management framework assessed by RBI to be sufficiently satisfactory for the parallel run.

1.6.4. A bank should submit to RBI during the parallel run period, the capital charge calculations for operational risk on quarterly basis duly certified by Statutory Auditors. Bank should also update RBI, on quarterly basis, about the progress made by the bank towards strengthening the ORMF, including rectification made in respect of deficiencies and areas of concern pointed.

1.6.5. If a bank becomes aware during the recognised parallel run that the bank no longer complies with any of the conditions or restrictions imposed by the RBI at the time of approving the TSA model, it shall –

(a) inform RBI as soon as practicable;

(b) assess the effect of the situation in terms of the risk posed to the bank;

*(c) prepare a plan to rectify the situation and inform RBI of its plan as soon as practicable;
and*

(d) undertake prompt corrective action in accordance with the plan prepared pursuant to sub-paragraph (c) above.

2. Para 2.4 is modified (bold and underlined) as follows:

2.4. Under the ASA, banks may aggregate retail and commercial banking (if they wish to) using a beta of 15%. Similarly, those banks that are unable to disaggregate their gross income into the other six business lines can aggregate the total gross income for these six business lines using a beta of 18%. As under TSA, the total capital charge for the ASA is calculated as the simple summation of the regulatory capital charges across each of the eight business lines, **with negative gross income treated as described in paragraph 1.3.**

3. Para 2.6 is added as follows:

2.6. Parallel Run

The guidelines pertaining to parallel run of TSA banks as explained in Para 1.6 of these Guidelines will apply mutatis mutandis to ASA banks.

B) Revisions / Changes in AMA Guidelines dated April 27, 2011

1. Para 2.3 is modified (bold and underlined) as follows:

2.3 Banks with overseas branches **and internationally active subsidiaries** intending to implement AMA should have capability to calculate capital under the AMA on global basis, even if the local regulators do not require the overseas branches to adopt AMA.

2. Para 4.1.10 is added to 'Appendix 1 (Part C, Para 4): Oversight of the ORMF' as follows:

4.1 Board Oversight

4.1.10. The board of directors and senior management of each subsidiary/overseas branch should be responsible for conducting their own assessment of the subsidiary's/overseas branch's operational risks and controls and ensuring the subsidiary/overseas branch is adequately capitalised in respect of those risks.

3. Para 8.4.4. is modified (bold and underlined) and a new para 8.4.5. is added as follows:

8.4 Qualitative Standards for ORMS

8.4.4. A bank should have techniques for allocating operational risk capital to business lines, **among various legal entities and across the banking group** for creating incentives to improve the management of operational risk, processes and practices throughout the bank. The bank should be able to demonstrate that the allocation will enhance transparency, risk awareness and operational risk management expertise in the bank.

8.4.5. AMA banking groups should continue efforts to develop increasingly risk-sensitive operational risk allocation techniques, notwithstanding initial approval of techniques based on gross income or other proxies for operational risk. The appropriateness of the allocation methodology will be reviewed with consideration given to the stage of development of risk-sensitive allocation techniques and the extent to which it reflects the level of operational risk in the legal entities and across the banking group.

4. Added to Para 8.5.4 as follows:

8.5.4 Essential Data Elements of an AMA Model

8.5.4.2. A bank should include in its ORMS the use of the above four AMA elements, in accordance with the following:

x) The bank should ensure that the bank's approach for weighting the four fundamental elements avoids the double counting of qualitative assessments or risk mitigants already recognised in other elements of the framework.

5. Added to Para 8.5.4.6. as follows:

8.5.4.6 Business Environment and Internal Control Factors (BEICFs)

xi) Over time, the process and the outcomes of BEICFs should be validated through comparison to actual internal loss experience, relevant external data, and appropriate adjustments made.