



15 December 2010

**Level of application: AMA firms**

**Consultation paper on Guidelines on AMA changes  
(CP 45)**

**1. Introduction**

1. Under Art. 105, Par.1 of Directive 2006/48/EC and Art 20 Par. 1 of Directive 2006/49/EC and subject to approval from competent authorities, credit institutions and investment firms (hereafter, institution(s)) are permitted within the Advanced Measurement Approach (AMA) to use their internal risk models to determine the regulatory capital charge for operational risk.

2. According to Art. 105, Par. 2 of Directive 2006/48/EC, institutions have to satisfy their competent authorities they meet the requirements on risk management systems and quantitative models set out in Annex X, Part 3 of Directive 2006/48/EC. An AMA including the internal risk model and risk management and control policies and procedures should, **at all times**, be tailored to the specific characteristics of the institution, so that its actual operational risk profile is effectively covered.

3. An **institution** is obliged to regularly review and, if necessary, to revise the AMA in response to changes in internal or external factors, for example, changes in its business activity or organisational structure, inclusion of additional data in the model, risk assessment, validation and audit results (Annex X, Part 3, par. 5, 6 and 7, lit. a in conjunction with Art. 105 par. 1 and 2 of Directive 2006/48/EC). An institution may also wish to extend the AMA to new components (e.g. use of insurance) for which approval has not yet been granted.

4. Extensions and some changes to the AMA can have a considerable impact on the quality and reliability of the AMA and the institution's capital requirements at group and solo level; it is therefore necessary to involve the competent authority prior to their implementation. If requests to extend or significantly change the AMA are submitted by an EU parent credit institution or jointly by the subsidiaries of an EU parent financial holding company, competent authorities will follow the procedures envisaged by Art. 129 Par. 2 of Directive 2006/48/EC.

5. The present Guidelines should assist an AMA institution in further developing its AMA. The Guidelines focus on the communication between institution and

competent authority and do not contain guidelines on how AMA changes should be implemented within an institution or group.

6. An institution should adopt internal policies for AMA changes, including procedures for the internal approval of AMA changes, taking into account their organisational characteristics and AMA specificities. The examples of extensions and changes, referred to in the annex to these Guidelines, aim to assist an institution in defining its internal categorisations relating to its AMA framework. When implementing the Guidelines, the competent authority will make clear how the institutions should provide information to the competent authority and how the feedback to the institution should be transmitted (e.g. formally or informally, by written notification or electronic means).

7. CEBS expects its members to implement the Guidelines on AMA changes by 31 December 2011.

## 2. AMA Change Policy (ACP)

### 2.1 Severity of changes to the AMA

8. An AMA framework may be altered by ***extensions or changes*** after being approved by the competent authorities.

9. An **AMA extension** means the introduction of new relevant AMA components (e.g. use of insurance, expected loss deduction), or the implementation of the AMA framework in parts of the group, for which approval has not yet been granted.

10. **Changes to an AMA** comprise modifications that are essential for meeting the regulatory requirements in the area of operational risk management (Annex X, Part 3, par. 2 and 5) and measurement systems (Annex X, Part 3, par. 8-31 of Directive 2006/48/EC); modifications with respect to internal governance structure and procedures are also included (Annex X, Part 3, par. 2-7, Article 22 and Annex V of Directive 2006/48/EC). The procedure for dealing with intended changes to the AMA varies depending on their severity.

11. Any intended change should not be considered in isolation, but should rather be assessed in connection with other changes that have been made previously, that have been applied for at the same time, or that have already been planned for the future. A per se insignificant change, in conjunction with other changes, might have a significant impact and should, in such cases, be considered accordingly.

12. Within an ACP (Section 2.2), the institution documents its principles and procedures for grading and processing planned AMA changes.

13. The ACP should use the following **categorisation scheme**, defined in more detail in the annex to these Guidelines, as to the first three categories:

- a) Extensions
- b) Significant changes
- c) Major changes
- d) Minor changes

14. Depending on the severity of an actual change (i.e. extensions or significant changes, major changes and minor changes) different requirements for the communication with the competent authority apply.

## **2.2 Internal AMA change policy**

15. The institution should approve at the proper hierarchy level, adequately document and implement, an AMA change policy (ACP) within its AMA framework. The ACP should include appropriate distinctive criteria for the categorisation of possible changes, outline the internal processes for implementing and documenting changes, and designate the responsible persons.

16. The institution should review and adjust the ACP to reflect changes within its internal governance or AMA framework as appropriate. The ACP and its application should be subject to independent review.

17. The institution should submit its ACP and any subsequent modification to the competent authority. If an institution's AMA is already approved, the competent authority should require an ACP to be handed in within 6 months of the implementation date of these Guidelines. Institutions applying to use an AMA should hand in an ACP as part of the required documentation.

18. Regardless of the distinctive criteria for the categorisation of possible changes within the institution's ACP, the competent authorities may upgrade or downgrade the severity of an actual AMA change and apply the respective supervisory procedures.

## **3. Supervisory procedures for AMA extensions and changes**

### **3.1 Supervisory procedures for extensions and significant changes**

19. Extensions and significant changes (see also Annex items A and B) should be subject to an explicit approval and should follow the supervisory procedures adopted for the application of an institution to use an AMA for determining the regulatory capital charge. The provisions set out in the CEBS Validation Guidelines, in particular those regarding home-host cooperation procedures; approval and post-approval processes (Section 2) should be applied as appropriate.

20. An institution wishing to extend or significantly change the AMA should file an application with the competent authority in good time, prior to the planned implementation, and submit the necessary documentation, including the outline of the extension or significant change, its rationale, objective and the expected effects on the AMA regulatory capital. The documentation should also include the report of the independent review of the planned extension or significant change.

21. After receipt of the complete application the competent authority assesses the proposed extension or significant change, initiates the appropriate approval process and subsequently makes a decision as to whether or not to grant the institution a permit to extend and/or significantly change the AMA framework. Where applicable, the cooperation procedures between competent authorities in line with Article 129 par. 2 of Directive 2006/48/EC should be followed.

22. The decision communicated to the institution may be supplemented with conditions (e.g. parallel run of the old and new AMA framework) or

recommendations for the improvement of the extended/changed parts of the AMA and their reasoning.

### **3.2 Supervisory procedures for major changes**

23. An institution should inform its competent authority in good time, prior to the planned implementation, of a major change to its AMA (see also Annex item C). Moreover, it should produce the necessary documentation, including the outline of the change, its rationale, objective and the effects on the AMA regulatory capital.

24. The competent authority evaluates the AMA change and informs the institution of any regulatory objections to the change<sup>1</sup>. The institution should apply the change for regulatory purposes only after receiving an affirmative reply from the competent authorities.

25. If the competent authority reclassifies the change as an extension or as a significant change, it will inform the institution, and a formal application and approval process should be carried out as described above (see chapter 3.1).

### **3.3 Supervisory procedures for minor changes**

26. Minor changes to the AMA should also be part of the ACP and should be documented appropriately. These changes may occur more often, but do not have a severe impact on the reliability of the AMA framework or the capital charge. However, such changes also need to be in line with the requirements set out in Annex X, Part 3 of Directive 2006/48/EC.

27. The competent authority should require an AMA-institution to notify minor changes, at least on a yearly basis. These changes may be reviewed within other AMA reviews, not specifically directed to such changes.

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<sup>1</sup> As above, this may entail recommended or mandatory remedial actions, suggestions for the possible improvement of the new/changed parts, or other specific requests (e.g. parallel run of the old and new AMA framework) and their reasoning.

## ANNEX

1. This Annex provides for extensions, significant changes and major changes - a non-exhaustive list of examples. This list acts as a guide to grading changes according to their severity.
2. The ACP should encompass the categories outlined in paragraph 13. The examples in those categories should be integrated in the internal ACP if feasible. The institution may add further detail in the ACP consistent with the characteristics of the institution's internal governance and AMA framework.

### A) Extensions to the AMA framework

- Extensions to the *scope of application* of the AMA
  - Extension to parts of the institution not yet covered by the approval, if not contained in the roll-out plan submitted with the application for the use of the AMA; and
  - Variation of a hitherto applied Partial Use relating to individual locations, legal units or business units, if not contained in the implementation plan submitted with the application for the use of the AMA.
- Extensions to the *measurement system*
  - First-time reduction of the AMA regulatory capital by the expected loss offset;
  - First-time introduction of operational risk mitigation techniques (e.g. insurance or other risk transfer mechanisms);
  - First-time introduction of diversification benefits; and
  - First-time introduction of an allocation mechanism at group level.

### B) Significant changes in the AMA

- Fundamental changes in the structure and characteristics of the calculation data set (e.g. first-time use of new external data sources, switch from incorporated external data sources);
- Fundamental changes in the measurement system due to modification in the logics or methods (e.g. a switch from essentially data-related approaches to mainly scenario-based models or vice-versa, changes in the criteria for the use or weighting of the four elements and changes in the distributional assumptions/parameter estimation procedure), or to important modifications within the group structure (e.g. abandonment of significant business units, including subsidiaries);
- Changes in the logics and drivers of the allocation mechanism; and
- Fundamental changes in the organisational and operational structure of the operational risk management function

### **C) Major changes to the AMA**

- Changes to the institution's internal procedures for collecting internal loss data, performing scenario analysis and determining business environment and internal control factors;
- Changes to the measurement system due to modification in the logics or methods, or to important changes in the group structure;
- Fundamental changeover of IT systems for the AMA framework, data administration or reporting procedures; and
- Changes to the institution's processes for internally validating and reviewing the AMA framework.
- Changes that cause a relevant alteration to the operational risk capital charge<sup>2</sup>

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<sup>2</sup> The alteration is to be calculated at group level, comparing the capital figure employing the model used for calculating the regulatory capital requirement and the proposed model after changes. All changes, which cause a relevant alteration of the capital figure have to be assigned to this category, even if the type of change is not named as a major change or assigned to another category in the institutions' ACP. If a type of change is named in the institutions' AMA change policy, such changes have, without consideration of their impact on the capital charge, to be treated according to the procedures applicable for the given category.