



The voice of banking  
& financial services

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Committee of European Banking Supervisors

Cc: [Andrew.sheen@fsa.gov.uk](mailto:Andrew.sheen@fsa.gov.uk)

Dear Mr Rummel,

### **CEBS CP 35 on the management of operational risk in market-related activities**

The British Bankers Association is the leading association for UK banking and financial services for the UK banking and financial services sector, speaking for over 220 banking members from 60 countries on the full range of the UK and international banking issues. I am pleased to say that all the major banking players in the UK are members of our association as are the large international EU banks, the US banks operating in the UK and financial entities from around the world. The integrated nature of banking means that our members are engaged in activities ranging widely across the financial spectrum encompassing services and products as diverse as primary and secondary securities trading, insurance, investment banking and wealth management, as well as deposit taking and other conventional forms of banking.

The British Bankers' Association ("BBA") is pleased to respond to the consultation on the draft updated guidance on the management of operational risk in market-related activities. Our response below draws out our discussion on the key issues. The annex to our letter contains our responses to the draft principles and guidance, and further observations.

We welcome the approach that takes into account the nature, scale and complexity of firms. This approach should be developed to avoid one size fits all. For example, the scope of the operational risk committee needs to align with the governance structure of the firm, which may have separate (board) committees for audit, remuneration, risk etc, and link the different types of risk. Outcomes should be identified and banks should be allowed to achieve them, adopting best practice along the way, according to their circumstances.

Operational risk in market-related activities can arise from many sources, such as poor or inefficient systems and processes, as well as sloppy trading practices and fraud (rogue traders). At present the consultation paper gives little focus to important areas of day-to-day operational risk management and focuses unduly on the comparatively rare area of rogue traders.

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## **Key messages**

1. There is broad general agreement amongst members that CEBS Consultation Paper 35 is a useful document and we welcome the effort to establish a best-practice framework for the management of operational risk across the industry.
2. On the whole, we found the Principles to be relevant and thought-provoking and welcome the effort to “highlight procedures, mechanisms and systems in trading areas that could prevent or mitigate operational risk events”. We note your acceptance in paragraph 8 that “the principle of proportionality should be taken into account in the application of the guidelines”. For this reason and because practices will vary according to the size, complexity, underlying businesses and geographical footprint of an organization we recommend, in some specific instances, reducing some of the detailed guidance with a view to ensuring the Principles remain generally applicable.
3. Principle 14 appears to be at odds with the statement in paragraph 7 that the “content of the paper is limited to the management of operational risks” as it seems to venture into Market and Credit Risk Management practices. It would be helpful to understand the operational risk Principle 14 is trying to address and to discuss the most appropriate controls to manage this. We do not feel this was adequately covered in the Public Hearing.
4. In order for these guidelines to be effective in global institutions they will need to be deployed across all regions; this will require the engagement of supervisors, both home and host, outside of the EU. We would welcome clarification on the extent to which this has been undertaken and the response received.
5. The current guidelines do not mention any requirement to book trades on a timely basis, although we would regard this as best-practice. This requirement may be inferred from Principle 9, but this Principle in its current form deals only with the requirement to book cash flows and we would observe that in many cases there will be no “day 1” cash-flows associated with a trade.
6. In the light of the extent of our comments we request a further consultation period following receipt of the revised draft and feedback table to which you referred in the Public Hearing. We draw to your attention that these comments contain a number of requests for clarification on the wording of the document and in some cases the underlying intent of the proposal and, as a consequence, we are therefore unable to provide complete comments at this stage.

## **Conclusion**

There is much to be welcomed in this paper. However, much is equally in need of clarification. Therefore, we would urge CEBS to issue another consultation between receipt of responses to CP 35 and finalising the guidelines to be implemented by national supervisors.

We hope that you will find our comments useful. Please contact me by way of email ([irving.henry@bba.org.uk](mailto:irving.henry@bba.org.uk)) or telephone on (0) 20 7216 8862 should you require further information.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'I. Henry', with a stylized flourish at the end.

Irving Henry  
Director, Prudential Capital and Risk

## Annex 1

### General comments

Further to the above messages on third countries and the European Banking Authority, we note that the objectives of CP 35 - which seems to have its basis in article 22 of the CRD - are driven by European directives, in particular the Markets in Financial Instruments Directive (MiFID) and the Market Abuse Directive (MAD). While we appreciate any guidance on the implementation of safe internal controls and best practices, we would stress the importance of clarity on the legal basis of any requirements. This is also important as the legal basis determines if “home” or “host supervision” applies. For example, CP 35 addresses voice recording. This is a control that is also addressed in MiFID, where it falls under the supervisory responsibility of the host supervisor. In contrast, in CP 35 it is implied in paragraph 1 that the contents of the guidelines would fall under the responsibility of the home supervisor as per article 22 of the CRD. We would appreciate clarification on this.

### Governance mechanisms

Principle 1: We agree with the principle. It should be noted that many UK firms have committees in place already tasked with oversight of audit, risk and remuneration.

Paragraph 12: “Guarantee” should be replaced with “provide for” as it is not possible for an organizational structure to guarantee segregation of duties with certainty.

Paragraph 13: The two sub-bullets should be removed from “to this end” through to “and accounting area” as Principle 1 is adequately supported by the main content of paragraphs 12 and 13, and the sub-bullets are observational and unduly prescriptive.

Principle 2: We agree with the principle. We would add that a culture designed to mitigate risk should be promoted firm-wide, rather than restricted to the front office.

The two hyphenated points require clarification. It should be pointed out that any disruption of how firms align control functions with lines of business may take away synergies. There should be no attempt to shoehorn firms into particular business models and management structures. Regulation should be structure neutral.

Paragraph 14: “Issuing a code of conduct” should be replaced with “having appropriate policies setting standards”. Many Firms have been built up over time and have developed a number of policies rather than a single code of conduct, which provide an appropriate control framework.

Paragraph 15, sub-bullet 1: “A policy establishing minimum absence requirements, ideally at least two consecutive weeks’ leave for traders (via a vacation, “desk holiday” or other absence from office or from trading), so that traders are physically unable to mark or value their own books, this responsibility being carried out by a different person during those periods” should be amended. This would cover jurisdictions where the enforcement of leave is not permitted and allow firms some flexibility in the implementation of the principle (e.g. by including periods of training within the minimum absence definition).

Principle 3: We agree with the principle.

Principle 4: We agree with the principle. Many firms take into account operational risk losses and even non-financial metrics when setting objectives - and assessing performance. "Losses" and "an individual's or business unit's" should be deleted. We believe that operational risk should be considered when setting performance objectives, rather than focussing only on operational losses which could vary substantially from period to period.

Paragraph 21 should be amended. For example, institutions may set objectives for business managers and traders in terms of a maximum acceptable level of operational risk in the attribution of their variable remuneration. This supports the revision of the Principle noted above.

Principle 5: We agree with the principle.

Paragraphs 22-23 should be deleted. Please see our comment on paragraph 24.

Paragraph 24 should be deleted and replaced with: "Institutions should implement appropriate fraud prevention and detection controls. These could include scenarios to increase understanding of how fraud might occur at various levels within the organisation and the institution's ability to detect and manage fraudulent activity, as well as fraud awareness training and integrated systems to link control alerts to identify fraud or other areas of heightened operational risk."

#### Internal controls

Principle 6: We agree with the principle.

Paragraph 27: "Precise" should be replaced with "appropriate" and "circumscribing" with "describing" and "activity of each trader" with "activities that each business / division may conduct". We believe that these controls can most effectively be implemented and managed at a business, desk or book level. Provided that the control framework is appropriate, this supports Principle 6 as it is written.

Paragraph 28: The reference to trading desks should be deleted from the text.

The text should be revised to read, "One objective of an authorised trading framework for the front office should be to formalise rules for trading desks enabling them to ensure they operate within a clear framework. Examples of deliverables could include lists of permitted products, market risk limits and supervisory guidelines for desk heads. The rules should be updated on an on-going basis. An appropriate process of escalation and challenge should be in place to investigate any breach of permitted activities or limit breaches." Again, we believe this supports Principle 6 as it is written and that the level of application of such controls should be at the discretion of the institution.

Paragraph 31: "Where permitted" should be inserted before "Traders' conversations" to reflect the legal requirements of different jurisdictions. "Taped" should be replaced with "recorded" to acknowledge that such recordings may be digital.

Principle 7: We recommend removing the sentence "Legal enforceability of the contracts should be assured". It is sometimes not possible to get such level of comfort.

Paragraph 32: We recommend amending the statement to read "arrangements should be agreed upon and documented in advance of trading where feasible".

Principle 8: We agree with the principle.

Paragraph 34: We recommend amending the statement to read "These trades should be identified as soon as possible by for review by the relevant control functions".

Principle 9: We agree with the principle. However, it is not clear what paragraph 37 means.

Paragraph 39: We are unclear as to the precise requirements of this paragraph and while we agree that Firms should have policies governing the standards of behaviour governing the relationships between traders and counterparties, the extent and nature of the review required is not clear. We recommend replacing “market counterparties” with “professional clients and eligible counterparties” as this is consistent with MiFID. We are also unclear as to the nature of the “commercial issues” that should be dealt with by control functions as the commercial aspects of a trade would normally be dealt with by the responsible business person.

Principle 10: We agree with the principle. However, it is not clear what paragraph 39 means.

Principle 11: We agree with the principle. It is not clear what paragraphs 45 – 8 mean. Are supervisors looking at confirmation or affirmation of processes? Do the recommendations address Nostro or treasury management? The recommendations appear to stray into liquidity and credit risks.

“Correctly” should be replaced with “appropriately”.

It is also unclear whether this Principle relates only to the requirement to have appropriate controls over Nostro balances. If this is the case then we agree, but would add that the requirement to follow up on breaks and aged balances on a timely basis should also be referenced. We seek confirmation that this point is not intended to cover liquidity management.

Paragraph 41: The statement that requires confirming the terms and conditions of transactions, at the very latest, before the end of the day is too prescriptive. We recommend deleting “(i.e. usually a few hours after the conclusion of the transactions and, at the latest, before the end of the day)” and replacing with “in line with regulatory requirements or market practices”.

Paragraph 43: It should be noted that not all trades are confirmed. Exceptions are, and should be, the focus.

The paragraph should be amended to: “Whilst it is best practice that counterparty confirmations are exchanged and matched for all market transactions, it is recognised that for certain counterparties or classes of transaction exceptions to this process may be appropriate. However, the criteria for granting exceptions to the process for exchanging counterparty confirmations must be clearly set out and risk-assessed by functions separate from the traders”.

Paragraph 44: “by a business unit independent of both functions” should be deleted as it is not clear how a unit independent of both front and back office would report in an organisation.

Paragraph 45: “Real-time” should be replaced with “timely” as real-time implies immediately after booking, not daily.

Paragraph 46: This should be deleted as it is not practical.

Paragraph 47: “While, on a daily basis, all the transactions should be reconciled with the general ledger” should be deleted.

Paragraph 48: While we accept that internal trades should be subject to appropriate controls, we do not agree that these should necessarily be the same as those in place with external counterparts and that alternative controls such as reconciliations or switch ticketing could satisfy the requirement as adequately as an internal confirmation process.

Paragraph 49, sub-bullet 3: We do not believe it is the role of the Regulator to direct staffing levels and feel that it would be more appropriate to require “An appropriate function to verify...”. We also propose amending “professional associations” with “industry associations”.

Paragraph 49, sub-bullet 4: “The use of secure commercial trading platforms capable of preserving a copy of each contract” should be replaced with “firms should retain documentation securely”. A commercial trading platform is only one method of achieving the requirement.

Paragraph 49, sub-bullet 5: Please delete “all” from “all transactions are confirmed”. As discussed earlier, institutions may have alternative controls in place of confirmations.

Paragraph 49, sub-bullet 6: We believe that CEBS is referring to failed settlements rather than unsettled transactions as many transactions may not settle for a number of years. If this is correct, please amend the draft to reflect this.

Paragraph 49, sub-bullet 7: This should be deleted as outsourcing does not necessarily change the operational risk profile and indeed can offer an enhanced control environment if appropriately managed.

Paragraph 49, sub-bullet 8: This should be deleted as this should be true for all sections of the guidelines.

Principle 12: We agree with the principle. It is not clear what paragraph 53 means.

Paragraph 50: “To a trader or a book” should be deleted as this is more appropriately done by counterparty.

Paragraph 53: The meaning of this paragraph is unclear. We agree that there should be independent validation of a trader’s Profit & Loss to ensure this makes sense in context, but this is covered by Principle 13. Therefore, we recommend its deletion.

Principle 13: We agree with the principle. It is not clear what paragraph 56 means. With regard to paragraph 57, there should be no granularity in the definition of the level and frequency of control.

Paragraph 55: Consideration should be given to the challenges associated with monitoring off-market rates for some Over The Counter products.

Paragraph 56: We would like clarification on the meaning of this paragraph.

Principle 14: It is not clear what this principle means, and it appears to stray into credit and market risks.

Principle 15: We agree with the principle, but replace “guarantee” with “ensure” as information systems cannot provide 100% certainty.

#### Internal reporting system

Principle 16: We agree with the principle.

Principle 17: We agree with the principle.

Paragraph 67: “A consolidated approach to risk management is imperative” should be replaced with “a comprehensive approach to risk management is recommended”. We recommend that the section from “For example ...” onwards should be deleted.

Paragraphs 68 and 69 should be deleted as they are simply observations.