Risk Accounting Standards Board's response

to the Consultation Paper on

" Draft Regulatory Technical Standards

- on establishing a risk taxonomy on operational risk that complies with international standards and a methodology to classify the loss events included in the loss data set based on that risk taxonomy on operational risk under Article 317(9) of Regulation (EU) 575/2013;
- on specifying the condition of 'unduly burdensome' for the calculation of the annual operational risk loss under Article 316(3) of Regulation (EU) 575/2013;
- on specifying how institutions shall determine the adjustments to their loss data set following the inclusion of losses from merged or acquired entities or activities under Article 321(2) of Regulation (EU) 575/2013."

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Table of Contents

Executive Summary

This document explores the application of risk accounting methodologies to address the requirements outlined in the European Banking Authority's (EBA) consultation paper on mandates in the loss group. By leveraging a structured and quantifiable approach, risk accounting provides comprehensive solutions to enhance data consistency, risk measurement, and regulatory compliance.

Enhancing Data Consistency and Clarity Risk accounting employs standardized risk units (RUs) to measure non-financial risk exposures, ensuring consistent and clear categorization of risks. This approach facilitates the granular and distinct classification of risk events, supporting the development of a harmonized risk taxonomy that aligns with international standards.

Accurate Risk Measurement and Reporting The use of RUs in risk accounting allows for precise quantification of various risk types, including greenwashing, environmental transition risks, and large loss events. By standardizing the measurement process, institutions can achieve accurate and comparable risk reporting, enhancing the reliability of risk assessments.

Efficient Data Integration and Standardization Risk accounting provides a robust framework for integrating loss data from merged or acquired entities. Through the application of RUs, institutions can standardize and validate loss data, ensuring timely and accurate integration into the overall risk management system. This approach addresses the challenges of data consistency and comparability during mergers and acquisitions.

Managing Uncertainty and Future Risks Risk accounting supports the identification and management of difficult-to-identify attributes, such as those related to future regulatory changes. By implementing scenario analysis and stress testing, institutions can quantify potential impacts in RUs, providing a structured approach to anticipate and prepare for regulatory shifts and other uncertainties.

Facilitating Regulatory Compliance Risk accounting methodologies ensure that institutions can meet the EBA's regulatory requirements efficiently. By providing a clear and standardized approach to risk measurement and reporting, risk accounting helps institutions demonstrate compliance with mandates related to operational risk loss calculation, risk taxonomy establishment, and data integration following mergers or acquisitions.

Supporting Continuous Improvement Risk accounting promotes continuous improvement in data quality and risk management practices. Through regular updates and refinements in the measurement and reporting processes, institutions can maintain high standards of accuracy and reliability in their risk assessments, supporting ongoing regulatory compliance and operational resilience.

In conclusion, applying risk accounting methodologies to the EBA's consultation paper requirements offers a structured, quantifiable, and standardized approach to managing operational risks. By enhancing data consistency, accuracy, and regulatory compliance, risk accounting provides a robust framework for institutions to effectively address the challenges and mandates outlined by the EBA.

Rationale for Using the Risk Accounting Method:

Risk Accounting was chosen as the basis for our responses due to its several key advantages:

1. Quantitative Precision: It allows for the detailed quantification of risk exposures, which is critical in accurately assessing and managing the operational risks associated with financial institutions' activities, especially those described in the BI components.
2. Regulatory Alignment: This method enhances compliance with regulatory mandates by providing a clear, transparent, and auditable framework for risk reporting and management, which aligns well with the expectations of the CRR3 amendments.
3. Adaptability and Relevance: Risk Accounting supports adaptable and dynamic risk management practices that can be tailored to specific institutional needs and changes in the regulatory landscape, ensuring that responses remain relevant over time.

The adoption of Risk Accounting principles in responding to this consultation paper ensures that our recommendations are not only theoretically sound but also practically viable and aligned with both current regulatory expectations and the operational realities of financial institutions. This approach provides a comprehensive framework that can significantly enhance the effectiveness of the CRR3 framework in managing and reporting operational risks, thereby supporting the overarching goal of financial stability and transparency in the European banking sector.

Our Answers

Question 1: Granularity and Distinction of Level 2 Categories

The granularity and distinction between different Level 2 categories are sufficiently clear if we apply a structured framework that quantifies non-financial risk exposures. Each category should be defined with specific parameters that align with standardized risk units (RUs), enabling precise measurement and comparison.

Risk accounting provides a structured framework for quantifying non-financial risk exposures using standardized risk units (RUs). By assigning specific RUs to each Level 2 category, institutions can achieve a granular and distinct measurement of risks. This method allows for precise quantification and comparison across different categories, ensuring clarity and consistency in risk reporting.

Question 2: Greenwashing Risk Classification

Greenwashing risk should be classified as an operational risk. This is due to the inherent processes and internal controls that fail, leading to misrepresentation. It should be mapped to categories that cover compliance breaches and reputational damage, as these often overlap in greenwashing scenarios.

Greenwashing risk can be effectively classified as an operational risk by incorporating it into the risk taxonomy. Risk accounting can measure the impact of greenwashing through RUs assigned to compliance breaches and reputational damage. This quantification helps institutions identify and manage the operational processes that lead to greenwashing, ensuring accurate risk assessment and mitigation.

Question 3: Mapping Greenwashing Losses

Greenwashing losses should be mapped to Level 1 categories related to compliance and reputational risk. Within Level 2, they should be associated with categories

specifically tracking failures in internal controls and misrepresentation to external stakeholders.

By mapping greenwashing losses to Level 1 categories related to compliance and reputational risk, and to specific Level 2 categories tracking control failures, risk accounting enables precise measurement of these losses. RUs can be used to quantify the financial and operational impact of greenwashing, providing a standardized approach to track and report these risks.

Question 4: Environmental Transition Risk

Environmental transition risk can be classified as an operational risk event. It should be mapped to Level 2 categories that deal with strategic risk and compliance, as these transitions often involve changes in policy and regulatory landscapes impacting operational processes.

Environmental transition risk, as an operational risk event, can be mapped to categories dealing with strategic risk and compliance. Risk accounting can quantify the impact of policy and regulatory changes through RUs, allowing institutions to measure and manage the operational risks associated with environmental transitions. This approach ensures comprehensive risk assessment and proactive management of transition-related risks.

Question 5: Difficult Attributes to Identify

Attributes related to future regulatory changes and their impact on operational processes are the most difficult to identify due to the uncertainty and lack of historical data. This uncertainty can be managed through scenario analysis and stress testing, quantifying potential impacts in RUs.

Attributes related to future regulatory changes and their operational impacts are challenging to identify. Risk accounting can manage this uncertainty through scenario analysis and stress testing, which quantify potential impacts in RUs. This method provides a structured approach to anticipate and prepare for regulatory changes, enhancing risk management practices.

Question 6: Inclusion of "Large Loss Event"

The inclusion of the attribute "Large loss event" is critical. Large loss events should be quantified using RUs to standardize the measurement across different scales and types of events, allowing for better aggregation and comparison of risk data.

Including "Large loss event" as an attribute is crucial for capturing significant risk exposures. Risk accounting can quantify these large loss events using RUs, standardizing the measurement, and enabling aggregation and comparison across different events. This approach ensures that large risk exposures are accurately captured and managed within the risk framework.

Question 7: Granularity of Proposed Attributes

The granularity of the proposed list of attributes is clear. However, an additional attribute capturing the frequency and severity of control failures across different processes would enhance the clarity. This attribute should also be measured in RUs to maintain consistency.

The proposed attributes are clear, but adding an attribute for the frequency and severity of control failures would enhance granularity. Risk accounting can measure these attributes in RUs, ensuring consistency and providing detailed insights into the effectiveness of internal controls. This approach supports comprehensive risk monitoring and management.

Question 8: Mapping Historical Data

Mapping the three years preceding the entry into force of these Draft RTS to Level 2 categories would be disproportionate due to the retroactive data alignment challenges. The main challenge is the inconsistency in historical data quality and format, which can be mitigated by focusing on forward-looking data collection and standardization.

Mapping historical data to Level 2 categories is challenging due to inconsistencies. Risk accounting can address this by focusing on forward-looking data collection and standardization. By using RUs, institutions can ensure that new data is consistently measured and reported, facilitating the transition and integration of historical data over time.

Question 9: Length of Waivers Post Merger/Acquisition

The length of the waivers (three years and one year) for institutions following a merger or acquisition is sufficient. This period allows for the stabilization of operational processes and accurate integration of loss data into the risk accounting framework, ensuring reliable risk measurement.

The waiver periods (three years and one year) are sufficient to stabilize operational processes post-merger or acquisition. Risk accounting can facilitate this integration by standardizing the measurement of risk exposures using RUs, ensuring reliable data integration and accurate risk assessment throughout the transitional period.

Question 10: Burdensome Cases for Annual Operational Risk Loss Calculation

Cases where institutions undergo significant organizational changes or face new regulatory requirements should be considered unduly burdensome for calculating the annual operational risk loss. These situations can be managed by implementing transitional arrangements and incremental data integration.

Significant organizational changes or new regulatory requirements can be burdensome for annual operational risk loss calculation. Risk accounting can manage these situations through transitional arrangements and incremental data integration. By measuring risks in RUs, institutions can maintain accurate risk assessments during periods of significant change.

Question 11: Difficult Provisions Post Merger/Acquisition

The most difficult provisions to implement post-merger or acquisition are those requiring the immediate standardization and integration of loss data. These difficulties arise from disparate systems and inconsistent data quality. A phased approach to data integration, using standardized RUs, would alleviate these challenges.

The most challenging provisions post-merger or acquisition involve the immediate integration of loss data. Risk accounting can alleviate these challenges by implementing a phased approach to data integration, using RUs for consistent measurement. This method ensures that risk data from merged or acquired entities is accurately captured and integrated.

Question 12: Data Integration in Mergers and Acquisitions

In practice, the provisions of this article would apply to most mergers and acquisitions. Data integration is typically prompt if institutions follow a structured framework for data standardization and validation, facilitated by the use of RUs to ensure consistency.

In most mergers and acquisitions, data integration is prompt if institutions follow a structured framework for data standardization and validation. Risk accounting can support this process by using RUs to ensure that loss data is consistently measured and integrated, facilitating timely and accurate risk reporting.

Question 13: Other Adjustments in Draft RTS

Additional adjustments should include provisions for continuous improvement of data quality and integration processes, ensuring that all operational risk data is consistently measured and reported using RUs. This approach would enhance the accuracy and reliability of risk assessments.

Additional adjustments should include continuous improvement of data quality and integration processes. Risk accounting can enhance these processes by ensuring that all operational risk data is measured and reported using RUs. This approach supports ongoing improvements in data accuracy and reliability, strengthening overall risk management.

Conclusion

In addressing the European Banking Authority's (EBA) consultation paper on mandates in the loss group, risk accounting has proven to be a powerful and effective methodology for meeting the outlined requirements. By applying standardized risk units (RUs), institutions can achieve a higher degree of precision and consistency in risk measurement and reporting, which aligns with international standards and best practices.

The granularity and distinction of risk categories are enhanced through the structured framework of risk accounting, ensuring that all risk events are comprehensively captured and accurately quantified. This approach facilitates better comparability and consistency within the banking sector, essential for regulatory compliance and effective risk management.

Classifying and mapping risks such as greenwashing and environmental transition risks into operational risk categories using RUs allows institutions to address these emerging challenges proactively. By quantifying these risks, institutions can manage them more effectively, ensuring they meet both regulatory expectations and internal control standards.

The identification and management of complex attributes, including those related to future regulatory changes, are significantly improved through scenario analysis and stress testing. These techniques enable institutions to anticipate potential impacts and prepare accordingly, thereby enhancing their resilience to regulatory shifts and other uncertainties.

The inclusion of attributes like "Large loss event" and the implementation of transitional arrangements for mergers and acquisitions underscore the practical applications of risk accounting in managing significant organizational changes. By using RUs, institutions can maintain accurate risk assessments even during periods of substantial change, ensuring continuity and stability in their risk management practices.

Overall, risk accounting provides a robust and adaptable framework that supports continuous improvement in data quality and risk management processes. By ensuring that all operational risk data is consistently measured and reported, institutions can maintain high standards of accuracy and reliability in their risk assessments, thereby strengthening their overall operational resilience and regulatory compliance.

In conclusion, the application of risk accounting methodologies to the EBA's consultation paper requirements demonstrates a comprehensive and effective approach to managing operational risks. This ensures that institutions are well-prepared to meet regulatory demands while maintaining robust internal controls and operational resilience.