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Regulation on the treatment of banks' operational risk according to the Basic Indicator Approach and the Standardised Approach

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EXECUTIVE BOARD
OF THE NATIONAL BANK OF MOLDOVA

DECISION no.113
of 24 May 2018

on the approval of the Regulation on the treatment of banks' operational risk
according to the Basic Indicator Approach and the Standardised Approach

Pursuant to Art.5 par.(1) letter d), Art.11 par.(1), Art.27 par.(1) letter c), Art.44 letter a) of the Law no. 548-XIII of July 21, 1995 on the National Bank of Moldova (republished in the Official Monitor of the Republic of Moldova, 2015, no.297-300, Art.544), with subsequent amendments and completions, Art.60 and 70 of the Law no.202 of 6 October 2017 on the Bank's activity (Official Monitor of the Republic of Moldova, 2017, no.434-439, Art.727), with subsequent amendments and completions, the Executive Board of the National Bank of Moldova

RESOLVES:

1. To approve the Regulation on the treatment of banks' operational risk according to the Basic Indicator Approach and the Standardised Approach, as laid down in the Annex hereto.

2. The Regulation referred to in paragraph 1 shall enter into force on 30 July 2018.

3. From the date of entry into force of the Regulation referred to in paragraph 1 of this decision, banks will ensure full compliance of their businesses, including internal policies and regulations, with its provisions.

Chairman
of the Executive Board

Sergiu CIOCLEA

Annex
approved by the Decision of the Executive Board
of the National Bank of Moldova
no.113 of 24 May 2018

Regulation on the treatment of banks' operational risk

according to the Basic Indicator Approach and the Standardised Approach

This Regulation transposes Art.1 letter a), Art.4 par. (1) sub-par.52, Art 312 par.(1), Art.313 par.(1) and (3), Art.314 par.(1) and (4), Art.315, Art.316 par.(1), Art.317, Art.318 par.(1) and (2), Art.319 and Art.320 of the Regulation No.575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, amending Regulation (EU) No. 648/2012, published in the Official Journal of the European Union no. L 176 of 27 June 2013, as amended by Commission Regulation (EU) 2015/62 of 10 October 2014.

CHAPTER I. GENERAL PROVISIONS

Section 1. Scope

1. This Regulation lays down the rules on own funds requirements for operational risk according to the Basic Indicator Approch and the Standardised Approach for the purpose of calculating own funds requirements in accordance with the regulatory acts of the National Bank of Moldova on own funds and capital requirements.

2. This Regulation shall apply to banks, which are legal persons of the Republic of Moldova, as well as to branches of foreign banks established in the Republic of Moldova.

3. This Regulation shall apply on individual and, where appropriate, consolidated basis.

Section 2. Definitions

4. The terms, concepts and expressions used in this Regulation have the meaning provided in the Law no.202 of 6 October 2017 on the Bank's Activity (hereinafter - Law no.202 of October 6, 2017) and in the regulatory acts of the National Bank of Moldova issued in application of that law.

5. For the purposes of this Regulation, the following definitions shall apply:
1) "formalization" shall mean the description and, where appropriate, the substantiation of a process, system, method or decision, issued by the bank in the form of a written presentation characterised by a sufficient degree of complexity and detail;
2) "operational risk" means the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk shall include legal risk (including, but not limited to, the bank's exposure to fines and other sanctions or compensation payments in the event of a failure to fulfil or inadequate fulfilment of legal or contractual provisions, as well as the fact that the bank's and / or its counterparty's contractual rights and obligations have not been properly stipulated).

Section 3. Prior approval and notification

6. To qualify for use of the Standardised Approach as laid down in Section 1 Chapter III of this Regulation, banks shall meet the criteria set out in Item 27, in addition to meeting the general risk management standards set out in Article 38 of the Law no.202 of 6 October 2017. Prior to start using the Standardised Approach, banks shall notify the National Bank of Moldova in accordance with the procedure laid down in Section 1 of Chapter IV.

7. To use an alternative relevant indicator for the business lines of "retail banking" and "commercial banking" where the conditions set out in Item 29 and the criteria listed in Item 27 are met, banks shall apply for prior approval of the National Bank of Moldova. The procedure of obtaining the NBM's prior approval is laid down in Section 2 of Chapter IV of this Regulation.

Section 4. Reverting to the use of less sophisticated approaches

8. Banks that use the Standardised Approach (TSA – Standardised Approach / ASA - Alternative Standardised Approach) shall not revert to the use of the Basic Indicator Approach (BIA) unless the

conditions set out in Item 9 are met.

9. A bank may only revert to the use of a less sophisticated approach for operational risk (BIA approach) where both the following conditions are met:
a) the bank has demonstrated to the satisfaction of the National Bank of Moldova that the use of a less sophisticated approach is not proposed in order to reduce own funds requirements related to the operational risk of the bank, is necessary on the basis of the nature and complexity of the bank, and would not have a material adverse impact on the solvency of the bank or its ability to manage operational risk effectively;
b) the bank has received prior approval of the National Bank of Moldova in accordance with the provisions of Section 3 of Chapter IV.

Section 5. Combined use of different approaches

10. Banks may use a combination of approaches provided that they obtain a prior approval from the National Bank of Moldova, which shall be granted where the requirements set out in Item 11 are met.

11. A bank may request a prior approval from the National Bank of Moldova to use a combination of the Basic Indicator Approach and the Standardised Approach only in exceptional circumstances, such as the recent acquisition of a new business, which may require a transitional period for the application of the Standardised Approach.

12. The National Bank of Moldova shall grant its prior approval in accordance with the provisions of Section 4 of Chapter IV only if the bank has committed to apply the Standardised Approach within a time schedule that has been submitted to and approved by the National Bank of Moldova.

CHAPTER II. BASIC INDICATOR APPROACH

Section 1. Own funds requirement

13. Under the Basic Indicator Approach, the own funds requirement for operational risk is equal to 15% of the average over three years of the relevant indicator as set out in Section 2 of Chapter II.
Banks shall calculate the average over three years of the relevant indicator on the basis of the last three twelve-monthly observations at the end of the financial year. When audited figures are not available, banks may use business estimates.

14. Where a bank has been in operation for less than three years, it may use forward-looking business estimates in calculating the relevant indicator, provided that it starts using historical data as soon as it is available.

15. Where a bank can prove to the National Bank of Moldova that, due to a merger, an acquisition or a disposal of entities or activities (for ex., the acquisition of a new business which was not carried out by the bank), using a three year average to calculate the relevant indicator would lead to a biased estimation for the own funds requirement for operational risk, the National Bank of Moldova may permit the bank to amend the calculation in a way that would take into account such events. In such circumstances, the National Bank of Moldova may, on its own initiative, also require a bank to amend the calculation.

16. Where for any given observation, the relevant indicator is negative or equal to zero, banks shall not take into account this figure in the calculation of the average over three years. Banks shall calculate the average over three years as the sum of positive figures divided by the number of positive figures.

Section 2. Relevant indicator

17. The relevant indicator is the sum of elements listed in Annex 1 to this Regulation. Banks shall include each element in the sum with its positive or negative sign.

18. Banks shall adjust elements listed in Annex 1 to this Regulation to reflect the following qualifications:

1) Banks shall calculate the relevant indicator before the deduction of any provisions and operating expenses. Banks shall include in operating expenses fees paid for outsourcing services rendered by third parties, which are not a parent or subsidiary of the bank or a subsidiary of a parent, which is also the parent of the bank. Banks may use expenditure on the outsourcing of services rendered by third parties to reduce the relevant indicator where the expenditure is incurred from a Moldovan or foreign bank complying with the requirements for prudential supervision and regulation, which are at least equivalent to those applicable by the Republic of Moldova (see Annex 5 to the Regulation on the treatment of banks' credit risk according to the Standardised Approach, approved by the decision no.111 of 24.05.2018 of the Executive Board of the National Bank of Moldova);
2) Banks shall not use the following elements in the calculation of the relevant indicator:
a) realised profits/losses from the sale of non-trading book items (as defined in the Regulation on the treatment of market risk according to the Standardised Approach, approved by the decision no.114 of 24.05.2018 of the Executive Board of the National Bank of Moldova);
b) income from extraordinary or irregular items;
c) income derived from insurance.
3) When revaluation of trading items is part of the profit and loss statement, banks may include revaluation in their calculations.

CHAPTER III. STANDARDISED APPROACH

Section 1. General provisions on the Standardised Approach

Sub-section 1. Own funds requirements

19. Under the Standardised Approach, banks shall divide their activities into the business lines set out in Annex 2 to this Regulation and in accordance with the requirements laid down in Item 25 and principles set out in Item 26.

20. Banks shall calculate the own funds requirement for operational risk as the average over three years of the sum of the annual own funds requirements across all business lines referred to in Annex 2 to this Regulation. The annual own funds requirement of each business line is equal to the product of the corresponding beta factor referred to in the Table of Annex 2 to this Regulation and the part of the relevant indicator (calculated in accordance with Section 2 of Chapter II) mapped to the respective business line.

21. In any given year in those three years referred to in Item 20, banks may offset negative own funds requirements resulting from a negative part of the relevant indicator in any business line with positive own funds requirements in other business lines without limit. However, where the aggregate own funds requirement across all business lines within a given year is negative, banks shall use the value zero as the input to the numerator for that year.

22. Banks shall calculate the average over three years of the sum referred to in Item 20 on the basis of the last three twelve-monthly observations at the end of the financial year. When audited figures are not available, banks may use business estimates.

23. Where a bank can prove to the National Bank of Moldova that, due to a merger, an acquisition or a disposal of entities or activities (for ex., the acquisition of a new business by a bank), using a three year average to calculate the relevant indicator would lead to a biased estimation for the own funds requirement for operational risk, the National Bank of Moldova may permit the bank to amend the calculation in a way that would take into account such events. In such circumstances, the National Bank of Moldova may, on its own initiative, also require a bank to amend the calculation.

24. Where a bank has been in operation for less than three years, it may use forward-looking business estimates in calculating the relevant indicator, provided that it starts using historical data as soon as it is available.

Sub-section 2. Principles for business line mapping

25. Banks shall develop and document specific policies and criteria for mapping the relevant indicator for current business lines and activities into the standardised framework set out in Annex 2 to this Regulation. They shall review and adjust those policies and criteria as appropriate for new or changing business activities and risks.

26. Banks shall apply the following principles for business line mapping:
1) banks shall map all activities into the business lines in a mutually exclusive and jointly exhaustive manner;
2) banks shall allocate any activity which cannot be readily mapped into the business line framework, but which represents an ancillary activity to an activity included in the framework, to the business line it supports. Where more than one business line is supported through the ancillary activity, banks shall use an objective-mapping criterion;
3) where an activity cannot be mapped into a particular business line, banks shall use the business line yielding the highest percentage (beta factor). The same business line equally applies to any ancillary activity associated with that activity;
4) banks may use internal pricing methods to allocate the relevant indicator between business lines. Costs generated in one business line which are imputable to a different business line may be reallocated to the business line to which they pertain;
5) the mapping of activities into business lines for determining own funds requirements for operational risk shall be consistent with the categories the banks use for credit and market risks;
6) the executive body, under the supervision of the Board of the bank, shall be responsible for the mapping policy;
7) banks shall subject the mapping process to business lines to an independent review (to be carried out by external auditors or a bank's subdivision not controlled by the executive body).

Sub-section 3. Criteria for the Standardised Approach

27. To use the Standardised Approach banks shall meet the following criteria:
1) the bank shall have in place a well-documented assessment and management system for operational risk with clear responsibilities assigned for this system. It shall identify its exposures to operational risk and track relevant operational risk data, including material loss data. This system shall be subject to regular independent review carried out by an internal or external party possessing the necessary knowledge to carry out such review;
2) the bank's operational risk assessment system shall be closely integrated into the risk management processes of the bank. Its output shall be an integral part of the process of monitoring and controlling the bank's operational risk profile;
3) the bank shall implement a system of reporting to the executive body that provides operational risk reports to relevant functions within the bank. The bank shall have in place procedures for taking appropriate action according to the information within the reports to management.

Section 2. Alternative Standardised Approach

Sub-section 1. Special provisions on the Alternative Standardised Approach

28. Under the Alternative Standardised Approach, for the business lines 'retail banking' and 'commercial banking', banks shall apply the following:
1) the relevant indicator is a normalised income indicator equal to the nominal amount of loans and advances multiplied by 0,035;
2) the loans and advances consist of the total drawn amounts in the corresponding credit portfolios. For the 'commercial banking' business line, banks shall also include securities held in the non-trading book in the nominal amount of loans and advances.

Sub-section 2. Conditions for using the Alternative Standardised Approach

29. To be permitted to use the Alternative Standardised Approach, a bank shall meet all the following conditions:
1) its retail or commercial banking activities shall account for at least 90% of its income;
2) a significant proportion of its retail or commercial banking activities shall comprise loans associated with a high PD;
3) the Alternative Standardised Approach provides an appropriate basis for calculating its own funds requirement for operational risk.

CHAPTER IV. NOTIFICATIONS AND APPROVALS

Section 1. Notification on the use of the Standardised Approach

30. The bank that intends to determine the own funds requirement for operational risk according to the Standardised Approach shall prior notify the National Bank of Moldova of its intention to use this approach, specifying the intended starting date of use. For this purpose , the bank shall submit to the National Bank of Moldova a request for notification, enclosing the documents specified in Annex 3 to this Regulation, and communicate to the National Bank of Moldova the names of the appointed person responsible for the maintaining the relationship with the National Bank of Moldova and his substitute.

31. In the course of the self-assessment process, the bank will take into account the provisions of Annex 4 to this Regulation, to be reflected in the document specified in Item 1 of Annex 3 to this Regulation.
To the extent necessary, external auditors may be involved in the self-assessment procedure.

32. Also, the document provided in Item 1 of Annex 3 to this Regulation is also necessary if the National Bank of Moldova carries out its own assessment to determine whether the bank complies with the requirements imposed by the provisions of this Regulation regarding the Standardised Approach.

33. Where a resident legal person bank is the parent undertaking and at the level of the group it is intended to use the Standardised Approach to determine the own funds requirement for operational risk, the parent bank shall submit to the National Bank of Moldova the request for notification on behalf of the bank's group, enclosing the documents specified in Annex 3 to this Regulation, complying with the provisions of Items 30 and 31 of this Regulation.

34. Where a resident legal person bank is a subsidiary of a foreign parent bank, and at the level of the group it is intended to use the Standardised Approach in order to determine the own funds requirement for operational risk, the resident legal person bank shall prior notify the National Bank of Moldova, submitting the documents specified in Annex 3 to this Regulation, complying with the provisions of Items 30 and 31 hereto.

35. The request for notification submitted by the bank shall be accompanied by accurate and complete information.

36. Whenever the information enclosed with the notification becomes inaccurate or incomplete in relation to the bank's activity, the bank shall notify the National Bank of Moldova of this fact and provide updated information.

37. Upon request, banks commit to provide any additional documents required by the National Bank of Moldova.

38. Where the considers that the additional documents at its disposal are of high relevance to the National Bank of Moldova's assessment of the request for notification of the use of the Standardized Approach for determining the own funds requirement for operational risk, it may transmit them together with the documents required in Annex 3 to this Regulation.

39. The National Bank of Moldova shall have a maximum of 30 working days from the date of receipt of the

request for notification and of all enclosed documents to assess whether the bank complies with the requirements laid down in the provisions of this Regulation for the application of the Standardised Approach.

40. Where a bank does not comply with the above-mentioned requirements for the Standardised Approach, the National Bank of Moldova will interdict the bank to use the Standardised Approach for determining its own funds requirements for operational risk by informing the bank in writing, within two working days of completion of the examination and without exceeding the assessment period, and indicating the reasons for its refusal.

41. Where upon expiry of the assessment period a bank has not received from the National Bank of Moldova an express written interdiction to use the Standardised Approach for determining its own funds requirements for operational risk, the notification shall be deemed to have been accepted.

Section 2. Prior approval for using the Alternative Standardised Approach

42. A bank that intends to determine the own funds requirement for operational risk according to the Alternative Standardised Approach shall request the National Bank of Moldova prior approval for the use of this approach, specifying the intended starting date of use. For this purpose , the bank shall hand in to the National Bank of Moldova a request of prior approval, enclosing the documents specified in Annex 3 to this Regulation, and communicate to the National Bank of Moldova the names of the appointed person responsible for the maintaining the relationship with the National Bank of Moldova and his substitute.

43. The provisions laid down in Section 1 of this Chapter shall apply accordingly.

44. In order to obtain prior approval for the application of the Alternative Standardized Approach, in the self-assessment process will be taken into account, in addition to those indicated in Annex 4 to this Regulation the provisions of Item 29, as well as the justification of how the use of the Alternative Standardized Approach leads to a more accurate assessment of the operational risk to which the bank is exposed.

45. The bank that no longer meets specific requirements for the application of the Alternative Standardised Approach, but complies with specific requirements for using the Standardised Approach, shall apply the Standardised Approach to determine its own funds requirement for operational risk and shall notify the National Bank of Moldova in writing of this fact, without enclosing to its notification any documents or information as specified in Annex 3 to this Regulation.

46. The National Bank of Moldova shall communicate to the bank whether it grants its prior approval for the use of the Alternative Standardised Approach. The prior approval notice may include additional requirements that the bank has to fulfil prior to the date on which it starts using the Alternative Standardised Approach for determining its own funds requirement for operational risk.

47. Identification by the National Bank of Moldova during its assessment process for prior approval of significant inaccuracies in the information provided by the bank or in the conclusions of the bank's self-assessment process respectively, leads to the refusal to grant prior approval for the use of the Alternative Standardised Approach to determine the own funds requirement for operational risk.

Section 3. Prior approval for reverting to the use of a less sophisticated approach for the operational risk

48. A bank that intends to revert from the application of the Standardised Approach / Alternative Standardised Approach to the application of the Basic Indicator Approach for the operational risk shall require for prior approval of the National Bank of Moldova to apply the Basic Indicator Approach taking into account the provisions of Item 9 par.1) of this Regulation, specifying the date from which it intends to apply it. In its application, the bank shall communicate the names of the appointed person responsible for the maintaining the relationship with the National Bank of Moldova and his substitute.

49. Where a bank fulfils the conditions of Item 9 par.1), the National Bank of Moldova shall communicate to the bank the granting of its prior approval for reverting to the use of the Basic Indicator Approach for

operational risk.

Section 4. Prior approval for using a combination of approaches

50. A bank that intends to use the Standardised Approach in combination with the Basic Indicator Approach for operational risk shall apply to the National Bank of Moldova for prior approval to use a combination of approaches, taking into account the provisions of Items 11 and 12 of this Regulation, specifying the date from which it wishes to use this combination.

51. If the National Bank of Moldova approves the time schedule for transition to the application of the Standardised Approach, it shall communicate to the bank the granting of its prior approval for using of the combination of operational risk approaches, in accordance with the provisions of Items 11 and 12 of this Regulation.

CHAPTER V. FINAL PROVISIONS

52. Banks shall calculate the own funds requirement for operational risk according to the Basic Indicator Approach for at least one year after the entry into force of this Regulation.

53. Banks that, after the expiration of the term specified in Item 52, intend to calculate the own funds requirement for operational risk using the Standardised Approach / Alternative Standardised Approach shall notify the use of the Standardised Approach / obtain prior approval for the using the Alternative Standardised Approach in accordance with the provisions of Section 1 / Section 2 of Chapter IV of this Regulation.

Annexes: DOC [1] PDF [2]

See also

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