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G5/2021

To: All banks, controlling companies, branches of foreign institutions, eligible institutions and auditors of banks or controlling companies

Guidance Note issued in terms of section 6(5) of the Banks Act, 1990

Supervisory Guidelines for the Advanced Measurement Approach (AMA)

Executive summary

Regulation 39 of the Regulations relating to Banks (the Regulations) requires banks, controlling companies and branches of foreign institutions (hereinafter collectively referred to as ‘banks’) to establish and maintain a process of sound corporate governance. This process includes the maintenance of effective risk and capital management by banks. In order to achieve the objective relating to the maintenance of effective risk and capital management, every bank should have in place the relevant required risk management processes, procedures and board-approved policies.

The purpose of this guidance note is to bring to the attention of banks specific international best practices related to operational risk and to clarify certain definitions and principles.

This Guidance Note replaces Guidance Note 2/2013

1. Operational Risk - Supervisory Guidelines for the Advanced Measurement Approach

1.1. In June 2011, the Basel Committee on Banking Supervision (BCBS) published a document relating to operational risk, namely “Operational Risk – Supervisory Guidelines for the Advanced Measurement Approaches”.¹ The information contained in the aforesaid document establishes guidelines applicable to banks on the advanced measurement approach (AMA).

1.2. Entities that have been approved by the Prudential Authority (PA) to make use of the AMA for operational risk will continue to be assessed against the principles contained in the the above-mentioned document.

2. Clarification of definitions and principles

2.1. In addition to the principles and practices contained in the aforementioned document, the PA wishes to also clarify certain definitions and principles contained in the Basel II Capital Framework and other related documents issued by the BCBS related to operational risk as set out in paragraphs 3 to 5 of this Guidance Note.

¹ Available at <https://www.bis.org/publ/bcbs196.htm>

3. Partial use and hybrid AMA

3.1. In order to remove any potential misunderstandings relating to the partial use and hybrid AMA related to operational risk, the PA wishes to provide the following clarifying comments:

3.1.1. a partial use of AMA indicates that a bank uses the AMA for some part of its operations, and either the basic indicator approach (BIA) or the standardized approach (TSA) for the remainder of its operations, as envisaged in regulation 33(5) of the Regulations; and

3.1.2. a hybrid AMA entails the attribution of group operational risk capital to legal entities by means of an allocation mechanism as envisaged in regulation 33(9)(c) of the Regulations. Under a hybrid AMA, one AMA model is used at, for example, a controlling company consolidated level with AMA capital being allocated to legal entities, thus meaning that the legal entities do not have standalone AMA models.

3.2. Banks are therefore reminded that for the purposes of calculating their exposure to operational risk and the relevant amount of capital and reserve funds required for operational risk, banks may only apply the AMA in respect of the legal entities as described to the PA during the bank's application process, and in respect of which the bank subsequently obtained the required approval from the PA.

4. Reverting to a simpler approach

4.1. Banks are reminded that once they have adopted one of the more sophisticated approaches for the measurement of their operational risk exposure, banks shall not revert to a simpler approach without the prior written approval of the PA, as set out in regulations 33(4) and 36(3)(b)(iii) of the Regulations.

5. Home-host supervisory co-operation and allocation mechanisms in the context of the advanced measurement approach

5.1. In January 2004, the BCBS issued a document entitled "Principles for the Home-host Recognition of AMA Operational Capital"² (hybrid AMA paper).³ The primary objectives of the hybrid AMA paper are to:

5.1.1. clarify the key elements of supervisory co-operation with respect to the implementation of the AMA and establish a framework of principles to facilitate information sharing in the assessment and approval of AMA methodologies; and

5.1.2. establish a set of principles to promote the development and assessment of allocation mechanisms incorporated in a hybrid AMA.


² Available at <https://www.bis.org/publ/bcbs106.htm>

³ The hybrid AMA paper is derived from the BCBS paper entitled "Principles for Home-host Supervisory Cooperation and Allocation Mechanisms in the Context of Advanced Measurement Approaches (AMA)"

- 5.2. It should be noted that the principles set out in the hybrid AMA paper do not supersede the general principles described in the paper entitled "High-level Principles for the Cross-border Implementation of the New Accord",⁴ but rather further elaborate on these principles in an operational risk context. Also, to the extent that the hybrid AMA paper refers to operational risk capital requirements, such references are limited to the Pillar 1 capital charge only.
- 5.3. The PA is of the view that the principles set out in the hybrid AMA paper will enhance home-host co-operation and information sharing among supervisors with respect to the approval and ongoing assessment of AMA methodologies, particularly as they relate to the hybrid AMA.
- 5.4. In this regard, the PA would like to emphasise the need for banks interested in implementing the hybrid AMA to work closely with relevant home and host supervisors to develop allocation mechanisms that appropriately reflect the operational risk profiles of all relevant subsidiaries and that meet any other requirements of the respective home and host supervisors.

6. Acknowledgement of receipt

- 6.1. Kindly ensure that a copy of this guidance note is made available to your institution's independent auditors. The attached acknowledgement of receipt, duly completed and signed by both the Chief Executive Officer of the institution and the said auditors, should be returned to the PA at the earliest convenience of the aforementioned signatories.



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Deputy Governor and CEO: Prudential Authority

Date: 2021-09-13

The previous guidance note issued was Guidance Note 4/2021, dated 8 July 2021

⁴ Available at <https://www.bis.org/publ/bcbs100.htm>