Annexure 5

South African Reserve Bank

Prudential Authority

Responses to operational risk comments received on Draft 2 of the proposed amendments to the 5th set of Regulations.

February 2024

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Introduction

1. In December 2017, the Basel Committee on Banking Supervision (BCBS) released the remaining components of the "Basel III: Finalising post-crisis reforms" package. These reforms aim to reduce the variability in the calculation of risk-weighted assets by banks. This will involve replacing the current approaches used by banks for calculating operational risk (OR) regulatory capital with a standardised approach, to be implemented in South Africa with effect from 1 July 2025, as outlined in Guidance Note 3 of 2023.
2. The standardised approach methodology for calculating operational risk is comprised of three components:
    - The Business Indicator (BI), which is a financial statement-based measure used as a proxy for operational risk.
    - The Business Indicator Component (BIC), which is derived by multiplying the BI by a set of regulatory-determined marginal coefficients.
    - The Internal Loss Multiplier (ILM), which is a scaling factor based on a bank's historical losses and the BIC.
3. The minimum operational risk capital is then calculated by multiplying the BIC and the ILM.
4. The standardised approach was included in the 5th set of proposed amendments to the Regulations relating to Banks (Regulations). The banking industry was invited to submit comments to the Prudential Authority (PA) in respect of the 5th set of proposed amendments to the Regulations by 21 October 2022. However, the industry requested a 2-week extension to submit their comments. All comments received were reviewed and addressed through draft 2 of the 5th set of proposed amendments to the Regulations, tier 3 legislation, and clarification provided where necessary. The comments were presented to and interrogated by various PA governance committees.
5. On 21 September 2023, the PA published the second draft of the proposed amendments to the Regulations, for public comment. Comments had to be submitted to the PA by no later than 25 November 2023.

List of Commenters

Name of organisation		
1. FirstRand Bank Limited (FRL)	2. Banking Association South Africa (BASA)	3. African Bank

OR Comments Matrix

No	Commenter	Reference in Draft Regulations	Comment/Issue (as provided by the commenter)	PA Response
1	BASA	Regulations – Page 115 – (i)	The regulations state: "appropriate and robust validation prior to the use of the bank's loss data for the calculation of the bank's minimum required amount of capital and reserve funds for operational risk;" To clarify: Must "robust validation prior to the use of the bank's loss data for the calculation" be performed each time a capital calculation cycle is performed.	The loss data will be subject to an independent review at inception and thereafter every second year or when required by the PA. Action: the process and timeframe are included in paragraph 3.2 of the Form BA 400 Directive.
2	BASA	Regulations – Page 121	The regulations state: "Provided that the bank shall appropriately include all relevant material timing losses in the bank's loss dataset when they are due to operational risk events that span more than one financial accounting period and give rise to legal risk." To clarify: Must the material timing losses item only be included if it gives rise to legal risk?	As per OPE 25[1] paragraph 25.26(5): Timing losses are "negative economic impacts booked in a financial accounting period, due to operational risk events impacting the cash flows or financial statements of previous financial accounting periods. Material "timing losses" should be included in the loss data set when they are due to operational risk events that span more than one financial accounting period and give rise to legal risk." The PA subscribes to the treatment of timing losses as described by the BCBS; therefore,

[1] Available at: https://www.bis.org/basel_framework/chapter/OPE/25.htm?inforce=20230101&published=20221208

No	Commenter	Reference in Draft Regulations	Comment/Issue (as provided by the commenter)	PA Response
				material losses should be included in the loss data set as described in the paragraph above. The matter will be discussed further with BASA for clarity. Action: none from a legislative drafting perspective since the wording is aligned to the Basel requirements.
3	BASA	Regulation 33 (j) (i) (page 130 from Annexure 1 – Draft Government Notice on proposed amendments to the Regulations)	Wording "... calculated in accordance with the relevant requirements specified in paragraph (g) hereinbefore, is equal to or greater than R4 billion..." perceived no longer relevant in the context of changes made to the text of regulation 33 (g) (ii) where references to absolute rand amounts were removed. This may result in reg 33 (j) (i) causing inconsistency in future when subsequent directives/instruments are issued to give effect to the intent of reg 33 (g) (ii) "Such amount or range and subject to such conditions as may be directed in writing by the Authority". Propose that the wording of reg 33 (j) (i) be amended to: "a bank's BI, calculated in accordance with the relevant requirements specified in paragraph (g) hereinbefore, is equal to or greater than R4 billion the effective amount specified in writing by the Authority in relation to the first bucket under paragraph (g)(ii); or"	The R4 billion will be removed from the subregulation and the subregulation will be reworded accordingly. Action: the R4 billion reference has been removed from the proposed amendments to the Regulations. The BI bucket information is included in paragraph 4.1 of the Form BA 400 directive.

No	**Commenter**	**Reference in Draft Regulations**	**Comment/Issue (as provided by the commenter)**	**PA Response**
4	FRL	Draft 2, Annexure 1, page 130, Draft regulation 33(7)(j)(i)	The lower Business Indicator (BI) bucket value (R4bn) specified in this paragraph differs from the lower BI bucket value (R5bn) specified in the "Proposed directive: Operational risk conditions, interpretation, and completion of the form BA 400" shared by the Authority in September 2023.	The R4 billion will be removed from the subregulation and the subregulation will be reworded accordingly. Action: the R4 billion reference has been removed from the proposed amendments to the Regulations. The BI bucket information is included in paragraph 4.1 of the Form BA 400 Directive.
5	FRL	Draft 2, Annexure 1, page 130, Draft regulation 33(7)(j)(i)	The Authority can consider not specifying the BI buckets in the Regulations but rather in a Directive.	An enabling provision has been inserted into the proposed amendments to the Regulations to enable the Authority to specify the BI buckets in a Directive.
6	African Bank	General	African Bank currently applies the alternate standardised approach and Grindrod Bank applies the Basic Indicator approach for the reporting of operational risk. As prescribed in point 4.3 the bank is comfortable with the new standardised approach for the calculation of operational risk based on the two components to determine the capital requirements. The bank would appreciate if the PA could provide guidance on whether the additional floor of 12% (as prescribed by the PA) is still required to be maintained for African Bank under the new standardised approach.	Action: the PA will have bilateral meetings with the bank to discuss the matter.