

Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (Text with EEA relevance)

PART THREE

CAPITAL REQUIREMENTS

TITLE III

OWN FUNDS REQUIREMENTS FOR OPERATIONAL RISK

CHAPTER 1

General principles governing the use of the different approaches

Article 312

Permission and notification

1 To qualify for use of the Standardised Approach, institutions shall meet the criteria set out in Article 320, in addition to meeting the general risk management standards set out in Articles 74 and 85 of Directive 2013/36/EU. Institutions shall notify the competent authorities prior to using the Standardised Approach.

Competent authorities shall permit institutions to use an alternative relevant indicator for the business lines of retail banking and commercial banking where the conditions set out in Articles 319(2) and 320 are met.

2 Competent authorities shall permit institutions to use Advanced Measurement Approaches based on their own operational risk measurement systems, where all the qualitative and quantitative standards set out in Articles 321 and 322 respectively are met and where institutions meet the general risk management standards set out in Articles 74 and 85 of Directive 2013/36/EU and Section II, Chapter 3, Title VII of that Directive.

Institutions shall also apply for permission from their competent authorities where they want to implement material extensions and changes to those Advanced Measurement Approaches. Competent authorities shall grant the permission only where institutions would continue to meet the standards specified in the first subparagraph following those material extensions and changes.

3 Institutions shall notify the competent authorities of all changes to their Advanced Measurement Approaches models.

4 EBA shall develop draft regulatory technical standards to specify the following:

- a the assessment methodology under which the competent authorities permit institutions to use Advanced Measurement Approaches;
- b the conditions for assessing the materiality of extensions and changes to the Advanced Measurement Approaches;

- c the modalities of the notification required in paragraph 3.

EBA shall submit those draft regulatory technical standards to the Commission by 31 December 2014.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.

Article 313

Reverting to the use of less sophisticated approaches

1 Institutions that use the Standardised Approach shall not revert to the use of the Basic Indicator Approach unless the conditions in paragraph 3 are met.

2 Institutions that use the Advanced Measurement Approaches shall not revert to the use of the Standardised Approach or the Basic Indicator Approach unless the conditions in paragraph 3 are met.

3 An institution may only revert to the use of a less sophisticated approach for operational risk where both the following conditions are met:

- a the institution has demonstrated to the satisfaction of the competent authority that the use of a less sophisticated approach is not proposed in order to reduce the operational risk related own funds requirements of the institution, is necessary on the basis of nature and complexity of the institution and would not have a material adverse impact on the solvency of the institution or its ability to manage operational risk effectively;
- b the institution has received the prior permission of the competent authority.

Article 314

Combined use of different approaches

1 Institutions may use a combination of approaches provided that they obtain permission from the competent authorities. Competent authorities shall grant such permission where the requirements set out in paragraphs 2 to 4, as applicable, are met.

2 An institution may use an Advanced Measurement Approach in combination with either the Basic Indicator Approach or the Standardised Approach, where both of the following conditions are met:

- a the combination of Approaches used by the institution captures all its operational risks and competent authorities are satisfied with the methodology used by the institution to cover different activities, geographical locations, legal structures or other relevant divisions determined on an internal basis;
- b the criteria set out in Article 320 and the standards set out in Articles 321 and 322 are fulfilled for the part of activities covered by the Standardised Approach and the Advanced Measurement Approaches respectively.

3 For institutions that want to use an Advanced Measurement Approach in combination with either the Basic Indicator Approach or the Standardised Approach competent authorities shall impose the following additional conditions for granting permission:

- a on the date of implementation of an Advanced Measurement Approach, a significant part of the institution's operational risks are captured by that Approach;

- b the institution takes a commitment to apply the Advanced Measurement Approach across a material part of its operations within a time schedule that was submitted to and approved by its competent authorities.

4 An institution may request permission from a competent authority to use a combination of the Basic Indicator Approach and the Standardised Approach only in exceptional circumstances such as the recent acquisition of new business which may require a transition period for the application of the Standardised Approach.

A competent authority shall grant such permission only where the institution has committed to apply the Standardised Approach within a time schedule that was submitted to and approved by the competent authority.

- 5 EBA shall develop draft regulatory technical standards to specify the following:
- a the conditions that competent authorities shall use when assessing the methodology referred to in point (a) of paragraph 2;
 - b the conditions that the competent authorities shall use when deciding whether to impose the additional conditions referred to in paragraph 3.

EBA shall submit those draft regulatory technical standards to the Commission by 31 December 2016.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.

CHAPTER 2

Basic indicator approach

Article 315

Own funds requirement

1 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 Article 316.

Institutions 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, institutions may use business estimates.

2 Where an institution 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.

3 Where an institution can prove to its competent authority that, due to a merger, an acquisition or a disposal of entities or activities, 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 competent authority may permit the institution to amend the calculation in a way that would take into account such events and shall duly inform EBA thereof. In such circumstances, the competent authority may, on its own initiative, also require an institution to amend the calculation.

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

Article 316

Relevant indicator

1 For institutions applying accounting standards established by Directive 86/635/EEC, based on the accounting categories for the profit and loss account of institutions under Article 27 of that Directive, the relevant indicator is the sum of the elements listed in Table 1 of this paragraph. Institutions shall include each element in the sum with its positive or negative sign.

Table 1

- 1 Interest receivable and similar income
- 2 Interest payable and similar charges
- 3 Income from shares and other variable/fixed-yield securities
- 4 Commissions/fees receivable
- 5 Commissions/fees payable
- 6 Net profit or net loss on financial operations
- 7 Other operating income

Institutions shall adjust these elements to reflect the following qualifications:

- a institutions shall calculate the relevant indicator before the deduction of any provisions and operating expenses. Institutions shall include in operating expenses fees paid for outsourcing services rendered by third parties which are not a parent or subsidiary of the institution or a subsidiary of a parent which is also the parent of the institution. Institutions may use expenditure on the outsourcing of services rendered by third parties to reduce the relevant indicator where the expenditure is incurred from an undertaking subject to rules under, or equivalent to, this Regulation;
- b institutions shall not use the following elements in the calculation of the relevant indicator:
 - (i) realised profits/losses from the sale of non-trading book items;
 - (ii) income from extraordinary or irregular items;
 - (iii) income derived from insurance.
- c when revaluation of trading items is part of the profit and loss statement, institutions may include revaluation. When institutions apply Article 36(2) of Directive 86/635/EEC, they shall include revaluation booked in the profit and loss account.

2 When institutions apply accounting standards different from those established by Directive 86/635/EEC, they shall calculate the relevant indicator on the basis of data that best reflect the definition set out in this Article.

3 EBA shall develop draft regulatory technical standards to determine the methodology to calculate the relevant indicator referred to in paragraph 2.

EBA shall submit those draft regulatory technical standards to the Commission by 31 December 2017.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.

CHAPTER 3

Standardised Approach

Article 317

Own funds requirement

1 Under the Standardised Approach, institutions shall divide their activities into the business lines set out in Table 2 of paragraph 4 and in accordance with the principles set out in Article 318.

2 Institutions 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 Table 2 of paragraph 4. The annual own funds requirement of each business line is equal to the product of the corresponding beta factor referred to in that Table and the part of the relevant indicator mapped to the respective business line.

3 In any given year, institutions 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, institutions shall use the value zero as the input to the numerator for that year.

4 Institutions shall calculate the average over three years of the sum referred to in paragraph 2 on the basis of the last three twelve-monthly observations at the end of the financial year. When audited figures are not available, institutions may use business estimates.

Where an institution can prove to its competent authority that, due to a merger, an acquisition or a disposal of entities or activities, 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 competent authority may permit institutions to amend the calculation in a way that would take into account such events and shall duly inform EBA thereof. In such circumstances, the competent authority may, on its own initiative, also require an institution to amend the calculation.

Where an institution 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.

TABLE 2

Business line	List of activities	Percentage(beta factor)
Corporate finance	Underwriting of financial instruments or placing of financial instruments on a firm commitment basis Services related to underwriting	18 %

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	<p>Investment advice Advice to undertakings on capital structure, industrial strategy and related matters and advice and services relating to the mergers and the purchase of undertakings Investment research and financial analysis and other forms of general recommendation relating to transactions in financial instruments</p>	
Trading and sales	<p>Dealing on own account Money broking Reception and transmission of orders in relation to one or more financial instruments Execution of orders on behalf of clients Placing of financial instruments without a firm commitment basis Operation of Multilateral Trading Facilities</p>	18 %
Retail brokerage (Activities with natural persons or with SMEs meeting the criteria set out in Article 123 for the retail exposure class)	<p>Reception and transmission of orders in relation to one or more financial instruments Execution of orders on behalf of clients Placing of financial instruments without a firm commitment basis</p>	12 %
Commercial banking	<p>Acceptance of deposits and other repayable funds Lending Financial leasing Guarantees and commitments</p>	15 %
Retail banking (Activities with natural persons or with SMEs meeting the criteria set out in Article 123 for the retail exposure class)	<p>Acceptance of deposits and other repayable funds Lending Financial leasing Guarantees and commitments</p>	12 %
Payment and settlement	<p>Money transmission services,</p>	18 %

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	Issuing and administering means of payment	
Agency services	Safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management	15 %
Asset management	Portfolio management Managing of UCITS Other forms of asset management	12 %

Article 318

Principles for business line mapping

1 Institutions 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 Article 317. They shall review and adjust those policies and criteria as appropriate for new or changing business activities and risks.

- 2 Institutions shall apply the following principles for business line mapping:
- a institutions shall map all activities into the business lines in a mutually exclusive and jointly exhaustive manner;
 - b institutions 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, institutions shall use an objective-mapping criterion;
 - c where an activity cannot be mapped into a particular business line then institutions shall use the business line yielding the highest percentage. The same business line equally applies to any ancillary activity associated with that activity;
 - d institutions 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;
 - e the mapping of activities into business lines for operational risk capital purposes shall be consistent with the categories institutions use for credit and market risks;
 - f senior management shall be responsible for the mapping policy under the control of the management body of the institution;
 - g institutions shall subject the mapping process to business lines to independent review.

3 EBA shall develop draft implementing technical standards to determine the conditions of application of the principles for business line mapping provided in this Article.

EBA shall submit those draft implementing technical standards to the Commission by 31 December 2017.

Power is conferred on the Commission to adopt the implementing technical standards referred to in the first subparagraph in accordance with Article 15 of Regulation (EU) No 1093/2010.

Article 319

Alternative Standardised Approach

1 Under the Alternative Standardised Approach, for the business lines 'retail banking' and 'commercial banking', institutions shall apply the following:

- a the relevant indicator is a normalised income indicator equal to the nominal amount of loans and advances multiplied by 0,035;
- b the loans and advances consist of the total drawn amounts in the corresponding credit portfolios. For the 'commercial banking' business line, institutions shall also include securities held in the non trading book in the nominal amount of loans and advances.

2 To be permitted to use the Alternative Standardised Approach, an institution shall meet all the following conditions:

- a its retail or commercial banking activities shall account for at least 90 % of its income;
- b a significant proportion of its retail or commercial banking activities shall comprise loans associated with a high PD;
- c the Alternative Standardised Approach provides an appropriate basis for calculating its own funds requirement for operational risk.

Article 320

Criteria for the Standardised Approach

The criteria referred to in the first subparagraph of Article 312(1) are the following:

- (a) an institution 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;
- (b) an institution's operational risk assessment system shall be closely integrated into the risk management processes of the institution. Its output shall be an integral part of the process of monitoring and controlling the institution's operational risk profile;
- (c) an institution shall implement a system of reporting to senior management that provides operational risk reports to relevant functions within the institution. An institution shall have in place procedures for taking appropriate action according to the information within the reports to management.

CHAPTER 4

Advanced measurement approaches

Article 321

Qualitative standards

The qualitative standards referred to in Article 312(2) are the following:

- (a) an institution's internal operational risk measurement system shall be closely integrated into its day-to-day risk management processes;
- (b) an institution shall have an independent risk management function for operational risk;
- (c) an institution shall have in place regular reporting of operational risk exposures and loss experience and shall have in place procedures for taking appropriate corrective action;
- (d) an institution's risk management system shall be well documented. An institution shall have in place routines for ensuring compliance and policies for the treatment of non-compliance;
- (e) an institution shall subject its operational risk management processes and measurement systems to regular reviews performed by internal or external auditors;
- (f) an institution's internal validation processes shall operate in a sound and effective manner;
- (g) data flows and processes associated with an institution's risk measurement system shall be transparent and accessible.

Article 322

Quantitative Standards

1 The quantitative standards referred to in Article 312(2) include the standards relating to process, to internal data, to external data, to scenario analysis, to business environment and to internal control factors laid down in paragraphs 2 to 6 respectively.

2 The standards relating to process are the following:

- a an institution shall calculate its own funds requirement as comprising both expected loss and unexpected loss, unless expected loss is adequately captured in its internal business practices. The operational risk measure shall capture potentially severe tail events, achieving a soundness standard comparable to a 99,9 % confidence interval over a one year period;
- b an institution's operational risk measurement system shall include the use of internal data, external data, scenario analysis and factors reflecting the business environment and internal control systems as set out in paragraphs 3 to 6. An institution shall have in place a well documented approach for weighting the use of these four elements in its overall operational risk measurement system;
- c an institution's risk measurement system shall capture the major drivers of risk affecting the shape of the tail of the estimated distribution of losses;

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- d an institution may recognise correlations in operational risk losses across individual operational risk estimates only where its systems for measuring correlations are sound, implemented with integrity, and take into account the uncertainty surrounding any such correlation estimates, particularly in periods of stress. An institution shall validate its correlation assumptions using appropriate quantitative and qualitative techniques;
 - e an institution's risk measurement system shall be internally consistent and shall avoid the multiple counting of qualitative assessments or risk mitigation techniques recognised in other areas of this Regulation.
- 3 The standards relating to internal data are the following:
- a an institution shall base its internally generated operational risk measures on a minimum historical observation period of five years. When an institution first moves to an Advanced Measurement Approach, it may use a three-year historical observation period;
 - b an institution shall be able to map their historical internal loss data into the business lines defined in Article 317 and into the event types defined in Article 324, and to provide these data to competent authorities upon request. In exceptional circumstances, an institution may allocate loss events which affect the entire institution to an additional business line "corporate items". An institution shall have in place documented, objective criteria for allocating losses to the specified business lines and event types. An institution shall record the operational risk losses that are related to credit risk and that the institution has historically included in the internal credit risk databases in the operational risk databases and shall identify them separately. Such losses shall not be subject to the operational risk charge, provided that the institution is required to continue to treat them as credit risk for the purposes of calculating own funds requirements. An institution shall include operational risk losses that are related to market risks in the scope of the own funds requirement for operational risk;
 - c an institution's internal loss data shall be comprehensive in that it captures all material activities and exposures from all appropriate sub-systems and geographic locations. An institution shall be able to justify that any excluded activities or exposures, both individually and in combination, would not have a material impact on the overall risk estimates. An institution shall define appropriate minimum loss thresholds for internal loss data collection;
 - d aside from information on gross loss amounts, an institution shall collect information about the date of the loss event, any recoveries of gross loss amounts, as well as descriptive information about the drivers or causes of the loss event;
 - e an institution shall have in place specific criteria for assigning loss data arising from a loss event in a centralised function or an activity that spans more than one business line, as well as from related loss events over time;
 - f an institution shall have in place documented procedures for assessing the on-going relevance of historical loss data, including those situations in which judgement overrides, scaling, or other adjustments may be used, to what extent they may be used and who is authorised to make such decisions.
- 4 The qualifying standards relating to external data are the following:
- a an institution's operational risk measurement system shall use relevant external data, especially when there is reason to believe that the institution is exposed to infrequent, yet potentially severe, losses. An institution shall have a systematic process for determining the situations for which external data shall be used and the methodologies used to incorporate the data in its measurement system;
 - b an institution shall regularly review the conditions and practices for external data and shall document them and subject them to periodic independent review.

5 An institution shall use scenario analysis of expert opinion in conjunction with external data to evaluate its exposure to high severity events. Over time, the institution shall validate and reassess such assessments through comparison to actual loss experience to ensure their reasonableness.

6 The qualifying standards relating to business environment and internal control factors are the following:

- a an institution's firm-wide risk assessment methodology shall capture key business environment and internal control factors that can change the institutions operational risk profile;
- b an institution shall justify the choice of each factor as a meaningful driver of risk, based on experience and involving the expert judgment of the affected business areas;
- c an institution shall be able to justify to competent authorities the sensitivity of risk estimates to changes in the factors and the relative weighting of the various factors. In addition to capturing changes in risk due to improvements in risk controls, an institution's risk measurement framework shall also capture potential increases in risk due to greater complexity of activities or increased business volume;
- d an institution shall document its risk measurement framework and shall subject it to independent review within the institution and by competent authorities. Over time, an institution shall validate and reassess the process and the outcomes through comparison to actual internal loss experience and relevant external data.

Article 323

Impact of insurance and other risk transfer mechanisms

1 The competent authorities shall permit institutions to recognise the impact of insurance subject to the conditions set out in paragraphs 2 to 5 and other risk transfer mechanisms where the institution can demonstrate that a noticeable risk mitigating effect is achieved.

2 The insurance provider shall be authorised to provide insurance or re-insurance and shall have a minimum claims paying ability rating by an ECAI which has been determined by EBA to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to institutions under Title II, Chapter 2.

3 The insurance and the institutions' insurance framework shall meet all the following conditions:

- a the insurance policy has an initial term of no less than one year. For policies with a residual term of less than one year, an institution shall make appropriate haircuts reflecting the declining residual term of the policy, up to a full 100 % haircut for policies with a residual term of 90 days or less;
- b the insurance policy has a minimum notice period for cancellation of the contract of 90 days;
- c the insurance policy has no exclusions or limitations triggered by supervisory actions or, in the case of a failed institution, that preclude the institution's receiver or liquidator from recovering the damages suffered or expenses incurred by the institution, except in respect of events occurring after the initiation of receivership or liquidation proceedings in respect of the institution. However, the insurance policy may exclude any fine, penalty, or punitive damages resulting from actions by the competent authorities;
- d the risk mitigation calculations shall reflect the insurance coverage in a manner that is transparent in its relationship to, and consistent with, the actual likelihood and impact of loss used in the overall determination of operational risk capital;

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- e the insurance is provided by a third party entity. In the case of insurance through captives and affiliates, the exposure has to be laid off to an independent third party entity that meets the eligibility criteria set out in paragraph 2;
 - f the framework for recognising insurance is well reasoned and documented.
- 4 The methodology for recognising insurance shall capture all the following elements through discounts or haircuts in the amount of insurance recognition:
- a the residual term of the insurance policy, where less than one year;
 - b the policy's cancellation terms, where less than one year;
 - c the uncertainty of payment as well as mismatches in coverage of insurance policies.
- 5 The reduction in own funds requirements from the recognition of insurances and other risk transfer mechanisms shall not exceed 20 % of the own funds requirement for operational risk before the recognition of risk mitigation techniques.

Article 324

Loss event type classification

The loss events types referred to in point (b) of Article 322(3) are the following:

TABLE 3

Event-Type Category	Definition
Internal fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, excluding diversity/discrimination events, which involves at least one internal party
External fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent the law, by a third party
Employment Practices and Workplace Safety	Losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims, or from diversity/discrimination events
Clients, Products & Business Practices	Losses arising from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product
Damage to Physical Assets	Losses arising from loss or damage to physical assets from natural disaster or other events
Business disruption and system failures	Losses arising from disruption of business or system failures

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Execution, Delivery & Process Management	Losses from failed transaction processing or process management, from relations with trade counterparties and vendors
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