The voice of banking
& financial services

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Cp35@c-ebs.org and bernd.rummel@c-ebs.org
Committee of European Banking Supervisors

Cc: Andrew.sheen@fsa.gov.uk

Dear Mr Rummel,

CEBS CP 35 (revised) on the management of operational risk in market-related activities

The British Bankers Association ("BBA") is the leading association for UK banking and financial services for the UK banking and financial services sector, speaking for over 220 banking members from 60 countries on the full range of the UK and international banking issues. I am pleased to say that all the major banking players in the UK are members of our association as are the large international EU banks, the US banks operating in the UK and financial entities from around the world. The integrated nature of banking means that our members are engaged in activities ranging widely across the financial spectrum encompassing services and products as diverse as primary and secondary securities trading, insurance, investment banking and wealth management, as well as deposit taking and other conventional forms of banking.

The BBA is pleased to respond to the revised consultation on the draft updated guidance on the management of operational risk in market-related activities.

We provided feedback on behalf of our members as part to the original consultation period and the further comments here should be considered as supplemental to our initial feedback. We recognise that CEBS has attempted to take into account most of the comments made and we would like to record our thanks for this. In particular we are grateful for the opportunity for a second consultation period, bearing in mind the extensive revisions to the first draft. However, in some areas where the public meeting and our written feedback requested additional explanation, little or none has been provided and it therefore remains difficult to provide detailed feedback, given that members find the text unclear or ambiguous. Accordingly the BBA has requested a meeting with CEBS so that the authors of the document can better explain some of their areas of concern prior to concluding the feedback process.

One point from the previous response is worth re-iterating. Operational risk in market-related activities can arise from many sources, such as poor or inefficient systems and processes, as well as sloppy trading practices and fraud (rogue traders). At present the consultation paper still gives little focus to important areas of day-to-day operational risk management and focuses unduly on the comparatively rare area of rogue traders.

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Comments

Principle 2:
§13. For clarity, we recommend removing the terms “back office” and “middle office” and replacing with an expanded list of functions, including “Operations and Settlements” and “Legal”.

The wording: Within each function, it should be ensured that, in handling business transactions, activities which are mutually incompatible are carried out by different persons.” should be replaced with “Duties should be allocated appropriately to support functions and individuals, also taking into account appropriate segregation of duties”.

§14. It is not clear what is meant by “integration of key procedures”. Is the assertion that co-operation between various control functions, including Finance, is likely to increase the level of surveillance and control of the trading activities?

§15: “A code of conduct” should be replaced with “appropriate policies and procedures setting standards”. Many groups have developed a number of policies and procedures, rather than a single code of conduct, which provide a risk control framework.

§24. This should be amended to: “Escalation processes should be in place to inform the appropriate level of management about incidents which exceed pre-determined risk tolerance levels or have certain characteristics, including those due to actual or suspicious fraud behaviour.” This reporting requirement should not be restricted to suspicious fraud behaviour. Any excess over pre-determined risk tolerance should be escalated.

The BBA in its response to the original CP 35 had recommended removal of paragraphs 23 – 26 and replacement with the following text, which we reiterate:

“Institutions should implement appropriate fraud and detection controls. These could include scenarios to increase understanding of how fraud might occur at various levels within the organisation and the institution’s ability to detect and manage fraudulent activity, as well as fraud awareness training and integrated systems to link control alerts to identify fraud or other areas of heightened operational risk.”

Principle 9:
As previously stated we agree with the principle, which indeed would apply to all aspects of a well controlled accounting system, not just to market-related activities. We would like CEBS to outline the particular risks that they are concerned about as this will enable detailed feedback. In particular we would welcome further clarity on what is meant by the phrase “systematic ex-post controls” (§35) what is being recommended in §37.

§35. We suggest that Finance is included in the list of control functions specifically referenced.

Principle 10:
§38. The reference to checks on the pricing of trades should be deleted as it duplicates the control referenced in §53.

§39. We would welcome further clarity on the sentence “Institutions should monitor these relationships and how operational risk events are treated by the front office”. If this text is referring to client relationship/ex-gratia payments/client accommodation payments made to clients, how they are controlled, approved and categorised then we would recommend that this is made clear in the paragraph. We would be happy to help assist in the drafting of appropriate wording.

Principle 11:
§47. We recommend that the paragraph be revised to read “Internal trades should be subject to controls creating the same level of confidence as those in place for trades with external counterparts” to reflect the fact that the types and nature of controls may be different for internal trades.

§48. Bullet 5: We note that the bullet still refers to the frequent review of unsettled transactions. We recommend that “unsettled” be replaced by “failed” as per CEBS response under 49-6.

Principle 12:
§49. The language in the revised text does not accommodate the previous feedback given We are concerned the paragraph could be interpreted as a recommendation that institutions reconcile margin calls at a book or a trader level, as a matter of course. We would like to understand the rationale behind the recommendation to reconcile margin and collateral calls to individual traders. In practice this is not practical, other than on an exception basis, since collateral management will be the product of trades across many books and products.

§52. The meaning of this paragraph is unclear. We agree that there should be independent validation of a trader’s Profit & Loss to ensure this makes sense in context, but this is covered by Principle 13. Therefore, we recommend its deletion.

Principle 14:
§58. We are concerned about the practicality of this principle and would welcome discussion in advance of suggesting alternative text. At present the wording appears to be written very much from the perspective of a proprietary trading book, whereas for many client-driven flows may pre-dominate and where it is neither realistic, nor desirable to restrict the gross size of, say, an interest rate swap book if trades contributing to that exposure are executed by clients for hedging purposes and are subsequently hedged by the bank in another market (e.g. futures).

We hope that you will find our comments useful. Please contact me by way of email (irving.henry@bba.org.uk) or telephone on (0) 20 7216 8862 should you require further information.

Yours sincerely,

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