ASSOCIATION

OPERATIONAL RISK REPORTING STANDARDS (ORRS)

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This document makes use of ***Hyperlinks*** for ease of navigation. ***Hyperlinks*** can be activated using Ctrl+Click with the keyboard and mouse, the cursor may change shape, for example to ☝. The Table of Contents also contains ***Hyperlinks.***

If ORX Members have queries on the text or would like to raise issues for concern then they should Email Mark Laycock of the ORX Secretariat, (mark.laycock@orx.org) with a description of the issue.

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Version Control

30 June 2011	3.1.2	Definition of Legal Risk
20 July	3.4.1	Requirement for Credit Risk-Operational Risk Boundary
28 September	3.2.3	Legal Events
9 December		Board ratifies DWG Recommendations
10 May 2012	3.2.4 4.2.2 4.2.3	Tax Decision Tree Negative Revenues becomes Revenue Adjustments Uncollected Revenues – added example, deleted example
15 June	1.5 3.2.4	Transitional Arrangements - deleted Categorisation of Tax related sanctions
27 June	3.2.3	Legal Costs Decision Tree

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1. INTRODUCTION

1.1 OBJECTIVES OF THIS DOCUMENT

This document describes the standards for reporting Operational Risk losses for consolidation and analysis in the ORX global database by Members of ORX. These standards may serve as a useful reference for Non-ORX firms for categorising Operational Risk losses; as such the standards are provided and published as an industry resource.

This document contains a number of definitions and principles to promote the consistency of reporting and data categorisation. The Definitions Working Group (DWG) has found it useful to refer to these definitions and principles when discussing issues around categorisation and various boundaries, in particular between Operational and Other Risks.

This 2011 edition of the Operational Risk Reporting Standards (ORRS) supersedes and replaces the current version from 2007. The main changes since the 2007 edition have been the addition of categories for Products, Processes and additional attributes for Large Losses.

ORX Members are free to adopt varying definitions and methodologies for internal loss recording and reporting. However, each Member is required to make submissions to the ORX global database following the uniform standards and definitions set out below.

These standards relate to the ORX global database of Operational Risk losses. A number of Sector Databases have been, or are in the process of being established by ORX. These Sector Databases may have particular emphasis on geography or business activity, for example Canada and Investment Banking. The standards for these Sector Databases may deviate in some way from the standards for the global database. The relationship between the Global and Sector databases is more completely described in Section 1.3 page 6.

Data submission to the ORX global database is made on a quarterly basis. Each time there is a data reporting cycle, Members will produce and send their data since inception (January 2002 for founding Members). Members are expected to report their full loss data history. See Section 7.4 "Exceptions to Complete Reporting" for further reference

ORX is aware that all Members are constantly refining their internal processes for capturing Operational Risk losses/events. As a consequence of this constant refinement, Members are allowed to modify and/or update their previously reported records.

A number of aspects around the ORX global database promote anonymity of the individual members. In some instances these aspects relate to the delivery of historic data by new Members, in other instances it affects the granularity of the reports back to Members. For example, Members provide country level data, but receive back regional level information. Anonymity and confidentiality around the ORX databases and data are important and are reflected in the Articles of Association of ORX.

1.2 DOCUMENT STRUCTURE

The document has been restructured, in comparison to earlier editions, to promote clarity and ease of finding details.

Each topic begins with a Principle / Definition section. This is then followed by the reporting Requirement and Examples. The final parts of the individual topic relate to Cross-References and ORRS Updates. The examples may be sub-divided into examples of Inclusions and examples of Exclusions.

Details of all categories can be found in an Appendix, which has been moved into a separate document. These detailed descriptions may include additional examples as well as notes.

1.3 RELATIONSHIP BETWEEN GLOBAL AND SECTOR DATABASES

This document is primarily concerned with the Operational Risk Reporting Standards that apply to the Global Database. As one of the strategic initiative for ORX is the development of Sector Databases it is important that the relationship between these Operational Risk Reporting Standards and the Sector Databases is clearly understood and appreciated.

Sector Databases may address a variety of interests, for example geographic or activity. An example of a Geographic Sector Database is the Canadian database. An example of an Activity Sector Database is Investment Banking.

Where the Sector Databases primarily have banks as Members and the focus is upon loss data then it is efficient for these Sector Databases to follow the standards for the Global Database. The efficiency is in terms of Standards and supporting system infrastructure. This implies that where the standards for the Global Database change then these changes will be reflected in the Sector Database.

Where the Members of the Sector Database agree to deviate from the standards for the Global Database they can do so. For example a Geographic Sector Database may decide to have a lower reporting threshold. An Activity Sector Database may decide to have additional exposure indicators and additional levels of granularity in Business Lines or Event Types.

Where the Sector Database does not have banks as Members, for example in the case of insurance companies (even if they are subsidiaries of banks) then changes will be required. Such changes may be in the detailed business lines and other data categories, such as Products. For the Sector Databases, the responsibility for agreeing and documenting the reporting standards belongs to the participants of that database.

In any case, substantial incremental costs from deviating from the standards of the Global Database may be reflected in the costs of membership to the respective database.

1.4 GOVERNANCE OF ORRS

Changes to the Operational Risk reporting standards must be approved by the Board of ORX. The Definitions Working Group has the responsibility for reviewing the Operational Risk Reporting Standards and making recommendations to the Board of ORX.

The Definitions Working Group will review requests from individual Members as well as from the Quality Assurance Working Group.

The Definitions Working Group has the authority to generate and publish clarifications of definitions or additional examples of particular situations. The vehicle for these clarifications is ORRS Updates.

The Definitions Working Group has the authority to recommend substantive changes to the Board of ORX during the year. This category also includes recommending categories for industry events for Board endorsement. The vehicle for these substantive statements is ORRS Updates.

The Definitions Working Group will conduct an annual review of the Operational Risk Reporting Standards. Changes may be in response to ORRS Updates since the last review.

2. DATA QUALITY GOVERNANCE

2.1 INTRODUCTION

This document, the ORX Operational Risk Reporting Standards, is part of a wider effort leading to Members receiving data from ORX that is fit for purpose. While ORX can support Members in achieving this standard, only Members can deliver the data that meets or exceeds the standards.

Members use the ORX data for a number of purposes, including:

- direct inputs to Economic or Regulatory capital calculations
- direct inputs or use in validating scenarios
- benchmarking capital calculation results
- supporting decisions in purchasing insurance
- assessing the Operational Risk performance of:
  - Businesses
  - Product Managers
  - Process Owners, and
  - Regional Managers

Although this document is updated periodically, Members are encouraged to use the ORRS Update process, operated by the Definitions Working Group, as a mean of clarifying the categorisation of losses.

In addition to this document ORX supports data quality through processes operated by the Quality Assurance Working Group (QAWG). The QAWG operates four quality related processes:

1. Data Cycle – Delivery Tests
2. Data cycle – In-Cycle Quality Assurance Testing
3. Periodic Portfolio Review
4. Annual Data Attestation Exercise

These processes are intended to support individual Members in their data deliveries as well as provide assurance to users of the data that it is fit for purpose.

2.2 ORX REQUIREMENTS & PROCEDURES

Definition: Data Quality has a number of dimensions. From an ORX perspective the following five dimensions are assessed during the quarterly data delivery cycles.

1. Timeliness of completing the data delivery,
2. Format of the data submissions
3. Completeness of the data delivery,
4. Adherence to the Operational Risk Reporting Standards, and
5. Responsiveness to data delivery enquiries made by PwC.

The Annual Data Attestation exercise and Periodic Portfolio review are additional processes to ensure data quality and may have some overlap with the assessments conducted as part of the data cycle, but they also capture additional features.

The last item is included as an aspect of data quality as the response time by Members can affect the timing of the publication of data which can have a knock-on impact on the ability of Members to use the data.

Requirement: Members are required to provide data that meets the requirements of the ORX data quality dimensions 1-5 plus accuracy***.***

Members are expected to conduct an annual data quality review involving an independent party. This independent party does not have to be an audit function but could be from Credit or another function with experience of categorising data. If Members are performing data quality reviews for internal and/or regulatory purposes then that should also be satisfactory for ORX purposes.

In the case of completeness of reporting, Members should be aware of the choices available for the reporting of reserves / provisions (Section 3.2.3), especially where litigation is involved.

Background: The QAWG has specified a number of tests to be applied, by the ORX Secretariat, to data prior to publication to ORX Members as well as the Annual Data Attestation Exercise and Periodic Portfolio Reviews.

ORX applies a number of pre-defined tests and reviews to the data, prior to distribution. The results of the tests are shared with PwC and PwC is asked to contact Members that reported particular loss events. Feedback from the Member to PwC is relayed back to ORX and the QAWG by PwC. The QAWG makes the decision as to whether the data is of adequate quality for publication.

The range of tests is expected to evolve as experience is accumulated and issues are brought to the attention of the QAWG by ORX Members.

3. WHAT TO REPORT – DEFINITIONS & BOUNDARIES

3.1 OPERATIONAL RISK

3.1.1 OPERATIONAL RISK

Definition: "Operational Risk (OR) is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputational risk" (see Basel II Accord section V. A. §644).

Cross-reference: In January 2001, the Basel Committee defined Operational Risk as used by ORX above. This definition has been applied within the respective local regulations, i.e. the European Commission's Capital Requirement Directive 2006/48/EC (CRD) for example as "Operational Risk means the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk."

Despite such differences in the texts, the definition of Operational Risk within the CRD should be read consistently with that of the Basel II Accord, meaning that reputational and strategic risks should be excluded from the scope of Operational Risk. (CEBS, 2009, Compendium). As an introduction to the details of the topic, the three paragraphs below are quoted from regulatory guidance.

As part of the bank's internal Operational Risk assessment system, the bank must systematically track relevant Operational Risk data including material losses by business line. It must have documented, objective criteria for allocating losses to the specified business lines and event types.

A bank's internal loss data must be comprehensive in that it captures all material activities and exposures from all appropriate sub-systems and geographic locations. Aside from information on gross loss amounts, a bank should collect information about the date of the event, any recoveries of gross loss amounts, as well as some descriptive information about the drivers or causes of the loss event.

A bank must develop specific criteria for assigning loss data arising from an event in a centralised function (e.g. an information technology department) or an activity that spans more than one business line, as well as from related events over time.

3.1.2 LEGAL RISK

Definition:

Legal Risk is the risk of loss resulting from exposure to 1) to non-compliance with regulatory and / or statutory responsibilities and/or 2) adverse interpretation of and/or unenforceability of contractual provisions. This includes the exposure to new laws as well as changes in interpretations of existing law(s) by appropriate authorities and exceeding authority as contained in the contract. This applies to the full scope of Group activities and may also include others acting on behalf of the Group. Legal Risk is a component of Operational Risk.

Cross reference:

Legal Risk includes, but is not limited to fines, penalties, or punitive damages from supervisory actions, or to judgments or private settlements (see Basel II Accord section V. A. §644 - Definition of Operational Risk) or to the reduction in asset values or cashflows.

Examples - Included in Reporting to ORX

- Change over time, in the interpretation by judiciary, of "treating customers fairly". This may result in the original treatment being classified as "unfair".
- Lack of Duty of Care or Negligence in executing responsibilities.
- Acting improperly in the termination of a finance agreement.
- Inaccurately or incorrectly drafted contracts or errors or omissions in documentation.
- Lack of due diligence on the accuracy of claims or statements in a prospectus for securities and/or underwriting.
- Use of somebody's Intellectual Property without appropriate permission(s).

3.2 OPERATIONAL RISK EVENT

Definition: An Operational Risk event is an event leading to the actual outcome(s) of a business process to differ from the expected outcome(s), due to inadequate or failed processes, people and systems, or due to external facts or circumstances.

ORRS Update:

ORX ORRS Update - (0026) Process PC0600 Stream-3 (Draft) 12 Aug 10.doc

3.2.1 GROUPED LOSSES (VS SINGLE EVENTS)

Definition: Grouped losses are defined as losses with the same underlying cause. For risk calculation purpose and ORX reporting purpose these have to be considered as a single event.

Events can be Grouped within a Business Line and between Business Lines (see also Section 3.2.2).

Requirement: An event may have multiple associated losses. In such cases, an investigation may be necessary to identify the “root event”—that is, the initial event without which none of the related losses would have occurred. For ORX purposes, the root event is included in a single record, containing all related losses, and is classified according to its specific event characteristics.

Examples - Included in Reporting to ORX

- Repeated mistakes due to a failure in the Business Model, a business process or due to a flawed product are considered to be a single event (e.g.in certain products the bank performs a systematic rounding to its benefit which is later found to be an abusive market practice). Note: such OR events are often triggered by retrospective changes in law or interpretation of law.
- Multiple refunds to clients are considered a single event when there is a common underlying allegation irrespective of the resolution of the cases through a class action lawsuit or individual lawsuits / voluntary settlements. (i.e. misstatement of issue prospectus, allegation that bank should have known of the deterioration of the condition of the financial asset) Such events may have a single provision set aside for all related claims.
- Multiple impacts from a single cause (e.g. many mis-priced transactions from a single incorrect piece of reference data, or refunds because documents are lost during a relocation), are considered to be a single event.
- Fraud losses connected by a common plan of action (e.g., the same scheme being used to defraud many different victims, which may involve many small transactions or small losses, a common perpetrator or organized criminal group), are considered to be a single event
- A technology outage which affects multiple lines of business.
- An individual or group which receives incorrect instructions which results in multiple losses should be aggregated due to the common cause.

Examples – Excluded from Reporting to ORX

- Multiple errors made by a single individual over a period of time are treated as single events and not to be grouped.

3.2.2 LINKED EVENTS

Definition: A linked event is a single event which impacts more than one business line.

Requirement: In cases where an Operational Risk event impacts more than one Business Line; members should assign the event to the Responsible Business - the business in which the event began. If responsibility for an event is factually unclear, then responsibility can be assigned according to one of the following rules which provide an approximation for splitting an event to more than one Business Line, for example:

- the owner of the transaction or
- business process out of which the event arose
- the P&L allocation can provide an approximation for splitting an event to more than one Business Line.

It should be noted that the splitting (and linking) of events is not permitted for any other category (e.g. Event Type, Product or Process).

Where the aggregated Gross Loss of all Grouped Losses reaches the threshold for Large Loss Events (currently €10 million), the Root Event is considered a Large Loss Event, for which additional Loss Attribute reporting is required; again the categories must be equal for all records reported to ORX.

Examples – Included in Reporting to ORX

- For events like natural disasters, where there is no business that is responsible for the event, then the event can be assigned to
  1. the business with the largest P&L impact, or
  2. to multiple business lines based on P&L, split of the incurred costs or some other metric, or
  3. or Corporate Items (this is the least desirable).

See next page for an Example of Relationship between Grouped, & Linked Losses

Example of Relationship between Grouped, & Linked Losses

There is a disease outbreak in Hong Kong affecting 3 business lines and corporate centre activities. Losses incurred are:

	Late Transaction Settlement	External Consultants hired to fill-in gaps	Costs to disinfect building etc	Total
Trading & Sales	100k	250k	50k	**400k**
Retail Banking		200k	100k	**300k**
Asset Mgt		300k	50k	**350k**
Corporate Centre (Finance)		100k	5k	**105k**
Total	**100k**	**850k**	**205k**	**1,155k**

Grouped Event: This is considered as one event for the firm with a total loss amount of 1,155k

Linked Event: This event affects multiple business lines so there are 4 linked records reported to ORX

Trading & Sales	400k
Retail Banking	300k
Asset Mgt	350k
Corporate Items	105k

Note that the event type is EL0501 - Disasters & Public Safety / Natural Disasters & Other Events.

ORRS Updates:

ORX ORRS Update - (0011) Loss Allocation Legal Entities (Req) 8 Apr 10.Doc
ORX ORRS Update - (0012) Loss Allocation Products (Req) 4 March 2010.Doc
ORX ORRS Update - (0015) Classification of Root Events (Prop)22 Jun 10.doc

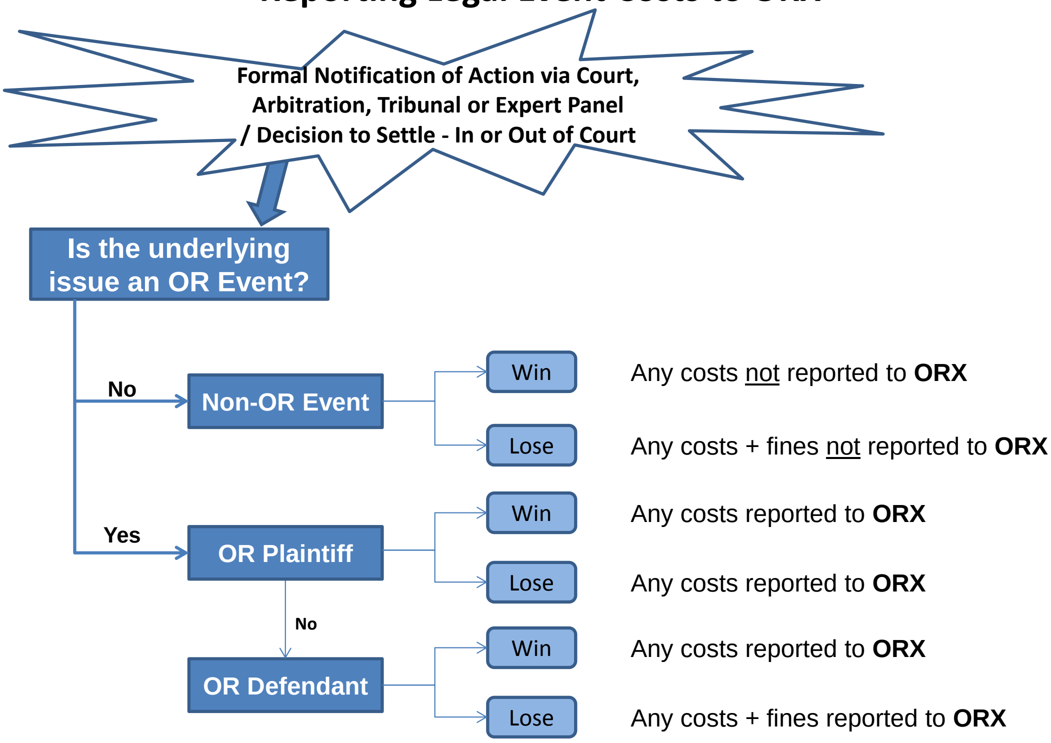
3.2.3 LEGAL EVENTS

Definition: Legal events are defined as dispute resolution activities especially with regard to legal risk (see Section 3.1.2). This may include litigation, arbitration and tribunals.

Requirement: A legal event is not an event type, it is in fact an issue arising from internal causes / failures and/or external causes. It encompasses all active, passive lawsuit (plaintiff /defendant) as well as out of court settlement, defence against frivolous and unsubstantiated claims.

Only legal events related to alleged or actual, operational risk events experienced by the Member are to be reported to ORX.

Reporting Legal Event Costs to ORX



For reporting, the event type classification follows the underlying allegation of the claim (for example “Suitability, Disclosure & Fiduciary” EL0401), the Date of Discovery is earlier of the date the claim is received by the bank or the event is discovered, the Date of Recognition is the date the first cost has been accounted for in the P&L and gross loss, for reporting to ORX, includes external lawyers fees, court fees, other Litigation expenses etc. as well as the cost of settlement.

Where the bank initiates (as plaintiff) a legal event the underlying Operational Risk loss must be recorded. External legal costs are to be reported as they are incurred provided the underlying event is an operational risk event. The verdict or settlement received from the defendant (if any), is considered a recovery. Where operational risk event is not alleged or experienced by the Member, then such legal costs are not to be reported to ORX.

If the firm's costs are to be paid by the counterparty, as determined by the court or tribunal etc., then the amount paid by the counterparty is treated as a Direct Recovery. (It is treated as a Direct Recovery, and not as a Rapid Recovery, as payment may take more than 5 business days to receive.)

In case that the existence of an underlying Operational Risk event is determined through a court decision, the event must only be reported at the settlement of the legal event. E.g. a former employee (fund manager) or partner of the bank is sued for alleged fraud; the court finds no evidence; he was only a poor fund manager. As there is no underlying Operational Risk event there is nothing to report to ORX.

A member has the option to report a reserve/provision for a legal event at the settlement date due to concerns related to "Discoverability" or other legal issues. The event is to be reported as soon as the legal impediment is removed and/or the case is settled. This rule does not apply when the bank publicly discloses the provision amount.

Examples – Included (non-exhaustive list) in Reporting to ORX

- Following a legal event, the bank has to bear legal costs but is compensated by the counterparty. The costs are to be entered as OpRisk losses (legal costs), the compensation from the counterparty as direct recovery.
- Following a legal event, the bank has to bear legal costs. The costs are directly paid by the counterparty to the recipient (law firm, court, etc.). These costs are not included in the gross loss amount.
- A bank enters a lawsuit on January 1st, legal fees arising during the year and subsequently are reported to ORX as they are incurred or provided/provisioned for. The settlement amount may be reported at the settlement date for discoverability reasons.
- Litigation resulting in a loss due to a fraud event (internal or external), where the firm had duty to prevent (as in forged checks, unauthorized credit card use, control of own employees, etc.);
- Successful legal defences where the full costs are not born by the counterparty
- Fines and claims following revenue overstatement, accounting errors and mark-to-market errors in institutions' financial accounts
- Violations of employment laws (including laws prohibiting discrimination);
- Losses for which the firm may bear vicarious liability;
- Loss resulting from accident/injury for which the firm may be legally responsible;
- Failure to follow regulatory prescriptions resulting in fines or assessments (taxes, money laundering, etc.);

- Losses due to retroactive changes in laws or regulations affecting the firm's business, even though they may not be avoidable (this constitutes an external impact). (changes in tax jurisdiction etc.);
- Misuse of third party intellectual property, patents, etc.;
- Fiduciary duty/conflict of interest violations;
- Consumer protection law/securities law/common law fraud/commercial conduct violations;
- Contract disputes (e.g. with insurance providers, service providers, outsourcing partners)
- Obligation to make client whole for losses resulting mismanagement of client property or transactions;
- Refunds (or discounts of future services) to customers caused by Operational Risk events, before the customers can lodge a complaint but, for example, after the institution has already been legally required to refund other customers for the same event;
- If a firm has suffered an Operational Risk loss as a victim (e.g., from unfair competition, contract violation, etc.) and seeks recovery through litigation

A trader is dismissed for alleged rogue trading after causing trading losses of €10m. The bank initiates litigation with the trader, who claims "no wrongdoing". If the trader wins, the loss is not Internal Fraud (EL01), but could be some other form of Operational Risk or Market Risk. It is not always certain, at the time the action is initiated, that this is an operational risk event. As a result, the reporting of losses including legal fees can only take place once the case is settled.

Examples – Excluded from Reporting to ORX

- If there is no underlying OR event then there is nothing to report to ORX, irrespective of whether the firm has incurred expenses
- Use of external counsel / attorneys for general advice, document preparation or review, legislative representation, etc. outside the context of a specific dispute or litigation.
- Technical litigation (inter-pleader, quiet title actions, etc.) in which the firm is not a substantive stakeholder.
- Court / tribunal / arbitration settlements which are used in certain jurisdictions as a standard procedure to determine a final payoff to an employee at retirement or when terminating a work contract (without any allegation of any wrongdoing on any side) whereas in other jurisdictions the amount of a settlement is determined via defined rules / laws.
- Legal costs and attorneys fees for credit/collection cases or other disputes not involving an Operational Risk event.

Cross-Reference:

Definition of Operational Risk	Section 3.1.1
Observation & Discovery Date	Section 3.3.1
Provisions	Section 4.2.5

ORRS Updates

ORX ORRS Update - (0006) Legal Risk No Blame (Req) 10 Dec 09.Doc
ORX ORRS Update - (0008) Legal Risk External Fees (Req) 10 Dec 09.Doc
ORX ORRS Update - (IE0013) Payment Protection Insurance (Rec) 7 May 10.Doc

3.2.4 TAX EVENTS

Definition: Tax events are defined as fines, penalties and legal costs from tax authorities on tax due to bank operations and in addition the unpaid tax when performing a service on behalf of clients. These Tax Events are a consequence of a prior event that led to the sanctions being applied by the tax authorities. As a result, Tax Events should be allocated to the event category that gave risk to them, for example EL0402 Improper Business or Market Practices.

		Liability for Tax		
Payment by:		Bank		External (e.g. clients, employees)
		Fine imposed	No Fine imposed	
Bank	fine	OpRisk loss	------	OpRisk loss
	interest	OpRisk loss	not reported	OpRisk loss
	tax payment	not reported	not reported	OpRisk loss
External	fine	not reported		not reported
	interest			
	tax payment			

Examples – Included in Reporting to ORX

- When performing a service on behalf of a client, the unpaid tax which can be claimed from the recipient of the service (i.e. client) is part of the loss, any recovery from a client would be considered as such.
- Withholding Tax claimed by Tax Authorities, not charged to the customer, due to misinterpretation of Regulation or procedural error (when the Banks acts as an agent of the Tax Authorities).
- Tax penalties and associated interest or regulatory fines
- Tax penalties and associated interest incurred when performing a service as an agent on behalf of the customers are treated as an Operational Risk event.

Examples – Excluded from Reporting to ORX

- Late Tax payments to Tax Authorities are not considered Operational Risk losses (even if they are disputed at court) as they may be regarded as timing impacts (see Section 3.3.2).

3.3 OPERATIONAL RISK LOSS

Definition: An Operational Risk loss is a negative and quantifiable impact on the P&L of the firm due to an Operational Risk event:

Requirement: ORX requires you to report all events where the gross loss is greater-than-or-equal-to EUR 20,000. It is in the responsibility of a member to ensure the collection and reporting of all Operational Risk events where the EUR 20,000 threshold applies. Whether to collect Operational Risk events below EUR 20,000 for internal purposes is left to the member – at present reporting of these events to ORX is not necessary.

3.3.1 LIFECYCLE OF AN OPERATIONAL RISK LOSS

Definition: Three important dates in the life cycle of an OR event are:

1. Date of Occurrence: the date when the event happened or first began,
2. Date of Discovery: the date on which the firm became aware of event, and
3. Date of Recognition / Accounting Date: the date when a loss or reserve/provision was first recognized in the P&L

Requirement: ORX requires the submission of three dates (occurrence, discovery, recognition / accounting) in connection with each event record:

For grouped losses the first date (occurrence, discovery, recognition) always used even if multiple losses are posted at different times in the General Ledger (Section 3.2.1). The event will subsequently be updated as the financial impacts are incorporated over time. The dates are generally constant over the lifecycle of an OR Loss.

Example – Included in Reporting to ORX

- A theft was perpetrated on November 10, 2003 [date (1)]. The theft was identified on December 15, 2003[date (2)]. The loss was booked in the P&L on January 15, 2004 [date (3)]. This event will be reported as a Q1-2004 loss for ORX.

Example – Excluded from Reporting to ORX

- Losses which are not recognized in the P&L, are not reported to ORX

3.3.2 TIMING LOSSES

Definition: Timing losses are due to Operational Risk events which result in the temporary distortion of an institution's financial accounts (i.e. material misstatement of the institution's financial statements).

Requirement: Timing Losses should NOT be included in the ORX submission. However, an initial timing loss may lead to an OR loss, which must be submitted.

This is a deliberate difference from the CEBS "Compendium of Supplementary Guidelines on implementation issues of Operational Risk" p 11.

Background: Although Timing losses are not reportable to ORX, it is considered useful for members to collect them in their databases for risk management purposes.

Examples – Included in Reporting to ORX

- An accounting error is made which results in the incorrect reporting of financial statements. As a result a fine is incurred. The fine is to be reported as an Operational Risk loss event (and NOT the correction of the financial statements).
- An account error is made which results in the incorrect reporting of financial statements. As a result a class action suit is filed and a settlement is made. The legal loss is to be reported as an Operational Risk loss event (and NOT the correction of the financial statements).
- In 2011 it was discovered that the P&L has been misstated for two financial years. The company expects a class action (e.g. as a consequence of a fallen share price) and therefore sets a provision aside. As this timing loss gives raise to legal risk and the P&L was misstated for over two periods, this timing loss is reportable to ORX. The reportable amount consists of the amount of the provision NOT the restatement of the P&L.

3.3.3 PENDING LOSSES

Definition: Pending losses are defined as losses from Operational Risk events which are temporarily booked in transitory and/or suspense accounts and are not yet recognized in the firms P&L.

Requirement: These events should **NOT** be reported to ORX,

Examples – Excluded from Reporting to ORX

- Funds are recovered through right of offset – i.e. funds are available in another account held by the customer and recovered from that other account
- Payment issued to wrong counterparty and the open position is posted to a suspense account.

3.4 BOUNDARY BETWEEN OPERATIONAL AND OTHER RISKS

The definition of “Operational Risk” is broadly worded to include all elements of an Operational Risk. But the wording could also be interpreted too broadly to include:

- certain non-operational events, as many business risk events from other risk types (details outlined in sections below) could technically be included within the phrase “inadequate or failed internal processes, people.”
- events that have OR aspects, but are already included in the capital regimes of other risk types, especially Credit Risk and Market Risk. The principle here is to avoid double counting.

Therefore, this section intends to provide clear guidance on the boundaries of OR, i.e. to define which events are reportable and which are not; thus the following boundary issues are addressed within this section:

- Credit Risk,
- Market Risk,
- Liquidity Risk,
- Strategic Risk,
- Business Risk,
- Project Risk, and
- Reputational Risk.

Requirement: Where the boundary relates to a risk category that also attracts regulatory capital then the overriding principle is that a firm only provides capital for the loss once. Under these circumstances the question is one of whether the capital calculation captures the risk / single loss data record. This rationale still applies even if the firm is using Standardized or Basic Indicator approach to determining capital for these risk categories.

3.4.1 CREDIT RISK

Definition: Credit risk is the risk of loss due to counterparty default - failure to meet a contractually pre-determined obligation.

Requirement: For ORX purposes, all individual Credit losses (provisions or depreciations based on the member bank's standards) above a threshold of €500k (a member may use lower thresholds internally are to be reviewed for the existence of an Operational Risk component. Where an Operational Risk component exists and the impact is equal to or above €20k, then event must be reported to ORX. If the OR component is within the Credit Risk regime (i.e. accounted for in the P&L as a credit loss **AND** reflected in Credit Risk Modelling), it is to be flagged as OR driven Credit Risk, if not, it is outright OR.

A member should report the OR component. If the Member is unable to identify the OR component then the full loan amount should be reported as an OR driven credit risk event.

Background: It is a Basel requirement for banks to record OR losses within Credit in their OR loss databases. Such events are characterized by the fact that they are OR by nature, however the loss due to default is already reflected in the Credit Risk capital calculations. To avoid double-counting, such OR losses within Credit are to be flagged and to be excluded from OR capital calculations.

Credit losses are usually either booked on specific accounts or embedded in trading P&L. Thus it is generally necessary for the OR function should see to it that employees involved in the credit risk related processes are trained in recognising operational losses to establish processes for analysis and recording of the OR component within these losses. As a consequence, for a number of Members, it can be the Credit Risk Impairment Team that is involved or even determines whether part of the loss is OR driven Credit risk and therefore justifies the “C” and reporting to ORX. It is important therefore that the Operational Risk management function liaise with their Credit counterparts to promote consistency between firms on the implementation of the Credit Risk Flag.

As this boundary is both accounting standard dependent and firm specific, it is acknowledged that in some cases the boundary defining credit losses may be drawn differently in member firms for the same type of loss. However, the ambiguity is not considered higher than in the credit processes themselves, i.e. the ambiguity is acceptable.

ORRS Updates

ORX ORRS Update - (0005) Madoff A (Req) 10 Dec 09.Doc
ORX ORRS Update - (0009) Trading Bk Risk Boundaries (Req) 5 Nov 09.Doc
ORX ORRS Update - (0010) Credit-OR Boundary Example (Req) 10 Dec 09.Doc

Examples – Included in Reporting to ORX (Operational Risks within Credit)

- Collateral failure: failure to properly apply for loan insurance, failure to make a public filing needed to “perfect” a security interest, failure to monitor collateral and make timely collateral calls, etc. In such cases, only the lost collateral value is reported to ORX (which may be lower than the full default amount);
- Procedural failure: where processing errors prevent recovery on a loan or actually enable a loss, as where a cash advance is made on a credit facility that was earlier cancelled by the loan officer;
- Fraud: loans obtained in a fraudulent transaction;
- Legal issues: loan documents may contain legal defects (invalid clauses, ambiguous terms, etc.);
- Scoring models: errors in scoring models may result in the approval of transactions that would not be admitted;

- Sales practices: certain sales practices may result in credit defaults.
- For capital purposes, any write-down due to loss of recourse may be considered credit loss.
- OR Losses are incurred because of technical errors by the lead bank in a loan syndicate. Syndicate Members agree to absorb part of the cost, since they recognize that they could have detected the lead bank's error at an earlier date. This is a direct recovery for the lead bank, and a gross loss for the syndicate members.

Cross-reference: Basel II Accord section V. A

> *Para 101 Operational Risk losses that are related to credit risk and have historically been included in banks' credit risk databases (e.g. collateral management failures) will continue to be treated as credit risk for the purposes of calculating minimum regulatory capital under this Framework. Therefore, such losses will not be subject to the Operational Risk capital charge.*
>
> *Para 102 Nevertheless, for the purposes of internal Operational Risk management, banks must identify all material Operational Risk losses consistent with the scope of the definition of Operational Risk (as set out in paragraph 644 and the loss event types outlined in Annex 7), including those related to credit risk. Such material Operational Risk-related credit risk losses should be flagged separately within a bank's internal Operational Risk database. The materiality of these losses may vary between banks and within a bank across business lines and/or event types. Materiality thresholds should be broadly consistent with those used by peer banks.*

Please note that an ORX project is currently working on further refinement of this section.

3.4.2 MARKET RISK

Definition: Market risk is defined as the risk of loss due to market prices changes on outstanding positions, due to discretionary market judgements.

Requirement:

- OR events within a bank that either cause a market risk loss or where market risk drives the severity are to be reported as an OR loss.
- OR events outside the bank that cause market risk losses within a bank or increase their magnitude are **NOT** to be reported. Only exception: External or Internal fraud directly against the bank.

Background: The original Basel II Accord has almost no guidance on the OR/MR boundary, and the ORRS version from 2007 also has limited coverage. In the meantime, the CEBS has published a compendium and ORX already has published case law on the topic, addressing major events that have occurred in the meantime. ORRS is in line with CEBS.

Examples – Included in Reporting to ORX:

- Rogue trading
- Human errors in transactions originated in market areas (e.g. fat finger, buy instead of sell). The amount to be reported is the amount of the mark-to-market impact in the in the daily (trading) P&L when discovered plus costs to unwind positions.
- Transaction processing errors (system outages, late execution, static data deficiencies, missed deadline)
- Stop loss or position limit violation: losses incurred from failure to properly execute a stop loss or excess of approved limits will be considered operational (only the amounts in excess of the stop loss or limit will be recorded).
- Error in pricing model – methodology or implementation
- Reimburse clients for alleged improper due diligence before fund sales.
- A security is bought when a sale was intended and the error is detected the same day, the market value on the day of the transaction is utilized for purposes of calculating impact, even if the security is held for period of time afterwards until a more favourable market environment develops. In this case impact is determined at the time the event is discovered.

Examples – Excluded from Reporting to ORX: (“OR driven MR”)

- Enron balance sheet fraud impacting market price of Enron shares in trading book
- Fraud at an (external) SPV impacting the market price of a security in the bank’s trading book
- Terrorist attack destroying assets of a firm held in private equity portfolio (on bank account)
- Market risk losses (e.g. trading losses, incorrect investment decisions) are not considered OR.

ORRS Updates

ORX ORRS Updates - (0005) Madoff A (Req) 10 Dec 09.Doc
ORX ORRS Updates - (0009) Trading Bk Risk Boundaries (Req) 5 Nov 09.Doc
ORX ORRS Updates - (IE0001) Visa (Req) 23 Apr 10.Doc

Cross-reference: Basel 2 CRD

> *Operational Risk losses that are related to market risk are treated as Operational Risk for the purposes of calculating minimum regulatory capital under this Framework and will therefore be subject to the Operational Risk capital charge.*

3.4.3 STRATEGIC RISK

Definition: “Strategic risk is defined as negative effects on capital and earnings due to business policy decisions, changes in the economic environment, deficient or insufficient implementation of decisions, or a failure to adapt to changes in the economic environment.“

Strategic risk losses occur when conscious business decisions in an uncertain environment (without any OR components like process failures or guideline breaches) retrospectively turn out to be wrong. They are often — but not always — associated with senior management decision making,

Requirement: Strategic Risk Losses are not recordable in the ORX database as they are not OR based on the Basel definition. This also holds for the strategic components of Project Risk (see section below).

Examples - Excluded from Reporting to ORX

- Decisions to invest in new business lines, products, assets, markets, services, equipment, projects, etc.;
- Merger and acquisition decisions;
- Restructuring / staff reduction;
- Regional or local based strategy (opening and closing branches or processing centres, etc.);
- Personnel hiring and termination decisions (unless carried out in a manner that violates legal or contractual requirements). See event category “Employee Relations” (Section 5.2 and the Appendix) for a more detailed explanation.
- Goodwill payments: The acceptance for relationship purposes of a loss (or making up for client’s losses) for which a client bears full responsibility is a strategic decision, and thus is not recordable. However, this applies only where the client is entirely at fault and the bank has filled its obligations (for instance reminding the client of their obligations on a timely basis). This does not excuse a case in which the firm books client fees but neglects to send bills for an extended period, and then decides to “forgive” the obligation when the mistake is finally discovered.

ORRS Updates

ORX ORRS Update - (0002) Strategic Risk (Req) 23 Apr 10.doc
ORX ORRS Update - (0003) Project Risk (Req) 10 Dec 09.Doc
ORX ORRS Update - (0004) Strategic Risk Goodwill (Req) 23 Apr 10.Doc

3.4.4 PROJECT RISK

Definition: A project is a temporary endeavour undertaken to create a unique product, service or result. A project has a definite beginning and end. The end of the project is reached when the project's objectives have been achieved or when the project is terminated because it will not or cannot achieve its objectives, or the need for the project no longer exists.

Project Risk is the Risk that the project does not:

- Provide the agreed functionality, and/or
- Complete within the Budget, and/or
- Complete on time.

Requirement: Based on the definition of Strategic Risk above, project risk losses incurred due to incorrect judgment and bad decisions are Strategic Risk and thus not reportable to ORX as they are not OR based on the Basel definition.

Examples – Included in Reporting to ORX:

"Normal" Operational Risk events that happen during the project are recognised as OR losses and are reportable to ORX (e.g. late or duplicate payments, frauds, guideline breaches)..For such individual events the decision as to whether they are included in Operational Risk reporting or not is based upon considering the event in isolation of any projects.

Examples – Excluded from Reporting to ORX:

Budget overruns, "scope creep" and project cancellations are not to be reported. The underlying judgments and decisions are similar to decisions to invest in new business, which may go wrong in a similar manner.

ORRS Updates:

ORX ORRS Update - (0002) Strategic Risk (Req) 23 Apr 10.doc
ORX ORRS Update - (0003) Project Risk (Req) 10 Dec 09.Doc

3.4.5 BUSINESS RISK

Definition: Business risk is defined as the risk that volumes may decline or margins may shrink, with no opportunity to offset the revenue declines with a reduction in costs. Business Risk captures the risk to the firm's future earnings, dividend distributions and equity price.

Requirement: Business Risk losses are not recordable in the ORX database.

Examples of Business Risk – Excluded from Reporting to ORX:

- Business risk measures the risk that a business may lose value because its customers sharply curtail their activities during a market down-turn or because a new entrant takes market share away from the bank.
- This risk increasingly extends beyond balance-sheet items to fee-generating services, such as origination, cash management, asset management, securities underwriting and client advisory services.
- Business Risk incorporates decisions around the mix of cost types, for example variable, semi-variable, semi-fixed and fixed costs. The cost of postage is a variable cost as it would not be incurred without having something to post. However, the cost of notifying a counterparty about a transaction is largely fixed due to the investment in computer systems and these costs would be incurred even if the transaction had not been executed.

Cross-reference: (Basel Committee published *"Ranges of Practices and Issues in Economic Capital Frameworks"* (March 2009) page 25)

3.4.6 REPUTATIONAL RISK

Definition: Reputational Risk is defined as the damage to the firm's reputation with relevant external parties, such as counterparts, clients, the shareholder community, governments, regulators etc.

Requirement: Reputational Risk is not recordable as an Operational Risk loss. This is true both

- where the entire impact of an event is reputational, and
- where reputational damage is one impact of an event that also has other, recordable losses (in this case only the recordable losses are submitted as an OR event to ORX).

3.4.7 LIQUIDITY RISK

Definition: The risk of loss arising from a situation where (1) there will not be enough cash and/or cash equivalents to meet the needs of depositors and borrowers, (2) sale of illiquid assets will yield less than their fair value, or (3) illiquid assets cannot not be sold or purchased at the desired time due to lack of market participants or capacity.

Funding Liquidity Risk is defined as the risk that the firm will not be able to meet efficiently both expected and unexpected current and future cash flow and collateral needs without affecting either daily operations or the financial condition of the firm.

Market Liquidity Risk is the risk that a firm cannot easily offset or eliminate a position at the market price because of inadequate market depth or market disruption.

Requirement: Neither of the two aspects of liquidity risk is reportable to ORX.

4. DETERMINE THE OPERATIONAL RISK LOSS AMOUNT – QUANTIFICATION

4.1 GENERAL PRINCIPLES

An Operational Risk event is not subject to ORX reporting unless it has a quantifiable negative impact on the P&L of the firm. Such impacts may be reflected anywhere in the P&L of the firm, and multiple impacts must be aggregated for submission. The quantifiable impacts are described below as Gross Losses and Recoveries (direct and indirect).

Splitting events is allowed when multiple Business Lines are impacted, even if the event is reflected as a single item in the accounts at Corporate level (see 5.3). In this case related events must be linked. It should be noted that the splitting (and linking) of events is not permitted for any other category (e.g. Event Type, Product or Process).

ORRS Updates

ORX Case Law - (0011) Loss Allocation Legal Entities (Req) 8 Apr 10.Doc

ORX Case Law - (0012) Loss Allocation Products (Req) 4 March 2010.Doc

4.1.1 GROSS LOSS

Definition: Gross Loss equals the sum of all P&L impacts related to an Operational Risk event before recoveries. Operational Risk gains, opportunity losses (Section 4.2.2), internal costs (overtime, bonus etc.) and timing losses (Section 3.3.2) are not reported to ORX although they may be collected internally by member banks.

In a few cases the Gross Loss may be based upon a definable or quantifiable economic impact upon the firm. Examples include uncollected revenue associated with contractual obligations and depreciated Fixed Assets, Investment Assets and Intangibles (Section 4.2.4).

Requirement: Gross Loss above the reporting threshold is reportable to ORX.

Examples – Included in Reporting to ORX - For ORX purposes, the following specific items are included in Gross Loss computation:

- Charges to P&L and write-downs due to Operational Risk events;
- Uncollected Revenues and Negative Revenues;
- External costs of repair or replacement made to restore the firm to its original pre-event position;
- External attorney fees paid in connection with Operational Risk litigation;

- Payments made to third parties for lost use of funds, net of amounts earned on funds held pending a late payment.
- A single event can cause both positive and negative P&L impacts. An example is a system outage in a bank, causing all trades in a location to be executed one day later. This may have a positive impact on some of the trades and a negative impact on others, depending on market movements and the trade details. These impacts are to be netted, as they are all components of the Gross Loss (i.e. the positive components are not to be considered recoveries as described below). If the net amount is a loss and exceeds the threshold, it is to be reported. In a special case this may even lead to the following submission to ORX: two linked events of €100k (loss) in Global Markets and -€50k (gain) in Equities. The reference business line should be the one where the losses occurred, as opposed to any gains).

ORRS Updates

ORX ORRS Update - (0010) Credit-OR Boundary Example (Req) 10 Dec 09.Doc

ORX ORRS Update - (IE0013) Payment Protection Insurance (Rec) 7 May 10.Doc

4.1.2 RECOVERIES

Definition: In some instances, Operational Risk losses can be reduced after–the-fact by recoveries. A recovery is an independent occurrence, separate in time from the original event, in which funds are recovered or contributed, usually from or by a third party. Recoveries may be direct or indirect. An indirect recovery is generally an insurance recovery (capital market products maybe there in the future). A direct recovery is any payment (other than an indirect recovery) received by the bank which offsets the loss.

Requirement: The reporting threshold for ORX submissions applies to the Gross Loss before any recoveries. Recoveries can only be recognised if the initial Gross Loss has been recognised in the P&L, i.e. recoveries are not appropriate for items in suspense accounts.

Direct recoveries are reportable to ORX.

Indirect recoveries are reportable to ORX, including those received from independent, regulated captive insurance companies (i.e. the indirect recoveries may be accepted by the firm's local regulator as eligible for capital reduction).

Examples – Included in Reporting to ORX:

- Payments received from an insurance company as a result of a claim made by the bank against an insurance policy is an indirect recovery.
- A firm incurs losses for which it initiates legal action (as plaintiff), claiming antitrust violations. Amounts received in settlement of the litigation represent a direct recovery relative to the original losses, for example external legal fees. (see Legal Events Section 3.2.3)

ORRS Updates

ORX ORRS Update - (0010) Credit-OR Boundary Example (Req) 10 Dec 09.Doc

4.2 SPECIAL CASES

4.2.1 RAPID RECOVERIES

Definition: ORX defines a rapid recovery as a P&L loss that is fully or partially recovered within no more than 5 business days from the Date of Recognition.

Requirement: Rapid recoveries are not separately reportable. A Rapid Recovery within the 5 business days can thus be deducted from the gross loss **OR** reported as a direct recovery.

Examples – Reflected in Reporting to ORX

- Payment made to wrong counterparty, the counterparty identifies the error and returns the entire payment within 5 business days of being initially posted to the P&L. As the Initial Loss and the Rapid Recovery net to €0 the event is considered to be a "near miss".
- A single error in payment system results in €100,000 being overpaid to two counterparts. One counterpart returns €65,000 within 2 business days of the overpayment. Gross Loss reported to ORX is €35,000 (= €100,000 - €65,000).
- A single error in payment system results in €100,000 being overpaid to two counterparts. One counterpart returns €65,000 within 2 business days of the overpayment. The outstanding €35,000 is repaid after 15 business days. The Gross Loss reported to ORX is €35,000 with a Direct Recovery of €35,000.
- For losses from misdirected payments this means that they should only be reported if they have not been fully recovered 5 business days after they have been booked from suspense account to P&L.
- A misdirected wire transfer not detected for several months, and once discovered the payment is not immediately returned on a voluntary basis. The firm books a loss on the P&L. After further negotiation, the firm is able to regain the funds after more than 5 business days. The event is reportable to ORX, the recovery is classified as a direct recovery.
- An erroneous wire transfer is made on June 29, the policy of the firm is to book these to P&L. The provisional P&L on the quarter end shows the wire transfer as a loss. On July 2 the firm recovers all of the money and makes a prior period accounting adjustment, within the 5 business day window for rapid recoveries. The net amount after recovery is €0. In this case the prior period accounting adjustment must be reflected in the amount reported to ORX to avoid inappropriate volatility in data used by ORX Members due to the use of the provisional accounts as opposed to the final accounts.

ORRS Update

ORX ORRS Update - (0022) Rapid Recoveries (Draft) 27 Aug 10.Doc

4.2.2 REVENUE ADJUSTMENT

Definition: Revenue Adjustment is where the impact of an operational risk event is incorporated into the revenue stream rather than being entered into a general ledger error account or the equivalent.

Requirement: Revenue Adjustments that are negative are to be reported to ORX.

By their very nature the impact of operational risk events resulting in Revenue Adjustments may not be fully reflected in the General Ledger. As a result events, that generate losses, which have been disclosed internally and are traceable will be reported to ORX. It is recognised the Members who use the general ledger as a reference will not be able to quality assure these Revenues Adjustments with the same degree of certainty over completeness or amount. As a result events which have been disclosed internally and are traceable will be reported to ORX.

Revenue Adjustments which represent gains may be captured by Members to provide a more complete picture of operational risk events.

Examples – Included in Reporting to ORX

- A trader executes a transaction, for a client ,the wrong way round, for example a buy instead of a sell. Upon identification reverses the transaction incurring a loss. The loss is incorporated into the daily P&L of the trader.

- A trader executes a transaction, as principal, and executes the wrong amount. Upon identification an adjustment is made to the position on the firm's balance sheet incurring a loss. The loss is incorporated into the daily P&L of the trader.

4.2.3 UNCOLLECTED REVENUE

Definition:

Uncollected revenue is defined as revenue which is not collected due to an operational risk event.

Requirement: Uncollected revenue is reportable to ORX when:

- There is an explicit decision not to collect revenue as a means of compensation following an operational risk event despite the existence of a contractual obligation on the side of the client.
- It is not realized as a result of an operational risk event and where the client does not have the contractual obligation to compensate the firm.

- It is not realized as a result of an operational risk event by the firm in the execution of the contractual obligation.

By their very nature the impact of operational risk events involving Uncollected Revenue may not be fully reflected in the General Ledger. As a result events which have been disclosed internally and are traceable will be reported to ORX. It is recognised the Members who use the general ledger as a reference will not be able to quality assure these Uncollected Revenues with the same degree of certainty over completeness or amount. As a result events which have been disclosed internally and are traceable will be reported to ORX.

Examples – Included in Reporting to ORX

- The bank decides to not charge a client the full fee in compensation for an operational risk event involving the client caused by the bank. The compensation is the amount to be reports as Gross Loss. (The bank decides to reduce or waive its fee for the next 6 months to compensate for a separate operational risk event).

- The bank compensates a client for an operational risk event through a revenue adjustment (suspension of a fee) rather than a compensation payment. An asset manager has an operational risk event (i.e. trading error) and compensates the client through a revenue adjustment (waiving or reducing contractual fees for a period of time).

- The bank charges a lower fee than contractually required due to an operational risk event. The bank decides not to claim the amount. (The contractual obligation was at 1.9% and the bank charged the client 0.9% interest due to an setup error and has made a decision not to go after the 1%.) This amount is to be reported as a Gross Loss.

Examples – Excluded from Reporting to ORX

- A bank issues an invoice to a client. The client does not pay. This constitutes uncollected revenue and is contained within credit risk. No operational risk event occurred.

- A product launch is cancelled due to an operational risk event. The budgeted revenue does not reflect a contractual obligation. This is an opportunity cost.

- A trader can not trade due to a power failure. The revenue that the trader wishes to have made is not a contractual obligation and constitutes an opportunity cost.

- A business unit is suspended due to regulatory sanction from conducting specific types of revenue generating activities. The uncollected revenues during the period of suspension are opportunity costs due to the lack of contractual relationship with clients.

- An ATM machine fails over a weekend. Any uncollected revenues that might have been generated are opportunity costs due to lack of contractual agreement with clients to use one or more ATMs.

- Undercharging or overcharging for product or services as the settlement amount would be treated as a timing error. E.g. wrongly overcharged interest rates or fees which are later refunded to the client. Although the event can be caused by operational risk, e.g. procedural failures or human mistakes, this is a timing error as the balance sheet / P&L is the same as it would have been if the error had not taken place.

4.2.4 FIXED ASSETS, INVESTMENT ASSETS, AND INTANGIBLES

Definition: The Gross Loss for Fixed Assets, Investment Assets and Intangibles deviates from using "book value" accounting standards to economic value. Economic value can be considered to be the cost of replacement. This is due to these accounting standards being established for purposes other than OR Management purposes.

Requirement: The following rules will apply for ORX reporting:

- If the damaged/lost asset is replaced, the recordable loss amount will be the replacement cost, on a net present value basis. For this purpose:
  1. Replacement cost is determined by the actual invoice or amount paid, or the present value of a new financing obligation;
  2. Relative costs of maintenance or operation (e.g., of a new building versus a destroyed building), are not to be taken into account;
  3. Enhancements are not part of replacement cost, but general improvements in replaced equipment, (e.g., due to interim technological advances), are not "enhancements".
- If a damaged/lost asset is not replaced, then the market value, if any, of the asset just prior to the event, will be recorded. In case there is no way to obtain the market value, then the book value will be used.

Note: This means that the loss will deviate from the P&L impact.

Any insurance recovery received will be reported as an indirect recovery.

Background: It is understood that accounting rules for fixed assets and intangibles will vary according to country. The rules above aim at reporting the economic impact and to ensure that events are reported similarly without regard to origin.

Examples – Included in Reporting to ORX:

- Destruction of a building that is fully depreciated

Examples – Excluded from Reporting to ORX:

- Misreporting of income from assets held in non Mark-To-Market books (investment assets) usually creates a timing impact, which can be fully corrected once discovered and which is not subject to ORX reporting.

4.2.5 PROVISIONS & RESERVES

Requirement: A provision or reserve taken for an individual OR Event must be included in the gross loss reported for the event. The amount reported to ORX should be adjusted in subsequent periods as the size of the provision/reserve changes.

If a provision is taken for several events whose background or impact is not individually determined, then the item is NOT reportable until the investigation is complete.

Background: Sometimes the impact of an Operational Risk event is reflected in the P&L by a provision, before it finally closed out. T his occurs most often in litigation matters or in complex events where additional time for investigation or repair is required.

ORRS Update

ORX ORRS Update - (0010) Credit-OR Boundary Example (Req) 10 Dec 09.Doc

Cross-reference: See also Section 3.2.3 – Legal Events for the reporting of provisions / reserves that are subject to on-going actions.

4.2.6 REGULATORY ACTION – FINES AND/OR PENALTIES

Definition: Regulatory action is defined as fines, penalties or settlements as a result of failure to follow regulatory prescriptions.

Requirement: Regulatory action falls in several categories, as listed below. Some categories are recordable as OR losses and some are not. It should be noted that regulatory action for one event is often composed of impacts falling in more than one of the categories.

Examples - Included in Reporting to ORX:

- Regulatory fine: Recordable as OR loss.
- Restitution to clients: Recordable as OR loss. Although the underlying idea is disgorgement of profits (i.e. repayment of profit made in the past that is not considered appropriate by the regulators), it has the character of backdated change in law, which is recordable.
- Mandatory contribution to fund or specific expenditure: Recordable as OR Loss, as it does not matter who receives the penalty.

Examples - Excluded from Reporting to ORX

- Close of business for some time (license suspension): not recordable, as this is an Opportunity Cost.
- Cost to fix the identified deficit: Not recordable, because these are generally investments to improve controls etc.

4.3 FX CONVERSION RATES

Requirement: When reporting to ORX, Members using base currencies other than Euro, must convert their loss amounts to Euro based on the exchange rate. The conversion should be performed with the internal booking date. The accounting date / recognition date of the event can be applied in the case where the internal booking date is not available for every single booking. The internal booking date must be the main driver for reporting purposes.

5. HOW TO CATEGORISE OPERATIONAL RISK LOSSES

This section provides an overview of the ORX categorisation dimensions. More detail on the individual category labels can be found in the separate document "ORRS Appendix – Detailed Description of Data Categories".

5.1 BUSINESS LINES

Definition: Business Lines represent profit centres where the revenues are generated from third parties, not allocations from other parts of the firm (service centres). In recognition that some events are experienced by the entire firm, or large part of the firm, there is a specially designated Business Line called "Corporate Items" (see Section 5.1.1).

The Business Lines used for reporting by ORX Members are similar to those used for reporting to the supervisors, but not exactly the same as can be seen in Table 1 below. It is not expected that any bank will have organised its business units or business divisions in accordance with ORX or supervisory business lines, as a result some allocation of Gross Income and OR Losses will be required (see Section 5.1.3 below Materiality).

The general objective of the Business Line attribute is to:

- Encompass the entire transaction / value chain,
- Include activities that may be performed centrally on behalf of the Business Line,
- Include activities that may be outsourced to non-bank group subsidiaries and/or third parties.

Essentially a Business Line has direct or indirect access to all of the resources to be equivalent to an independent company, for example finance, accounting, HR, IT, capital etc..

Requirement: ORX requires the allocation of *all Operational Risk events* to a Level 2 Business Line.

5.1.1 CORPORATE ITEMS

Definition: The Business Line Corporate Items has been created for purely corporate level items, such as those affecting the Board of Directors (or the equivalent) as a whole or as individuals, misreporting financial statements, or other events at the corporate centre. Corporate Items is meant to be a narrow category and is not expected to include business losses to avoid specifying ownership or accountability. A Corporate Item must not be part of an allocation of loss that is an element of an event affecting multiple Business Lines.

The extent of use of this category by member banks is monitored as an element of the in-cycle quality assurance. All members are expected to report fewer than 10 % of their total number of events or gross loss in this category.

As a service centre, Corporate Items does not have any Gross Income. If Gross Income is associated with the loss then it must be mapped to a business line that is a profit centre.

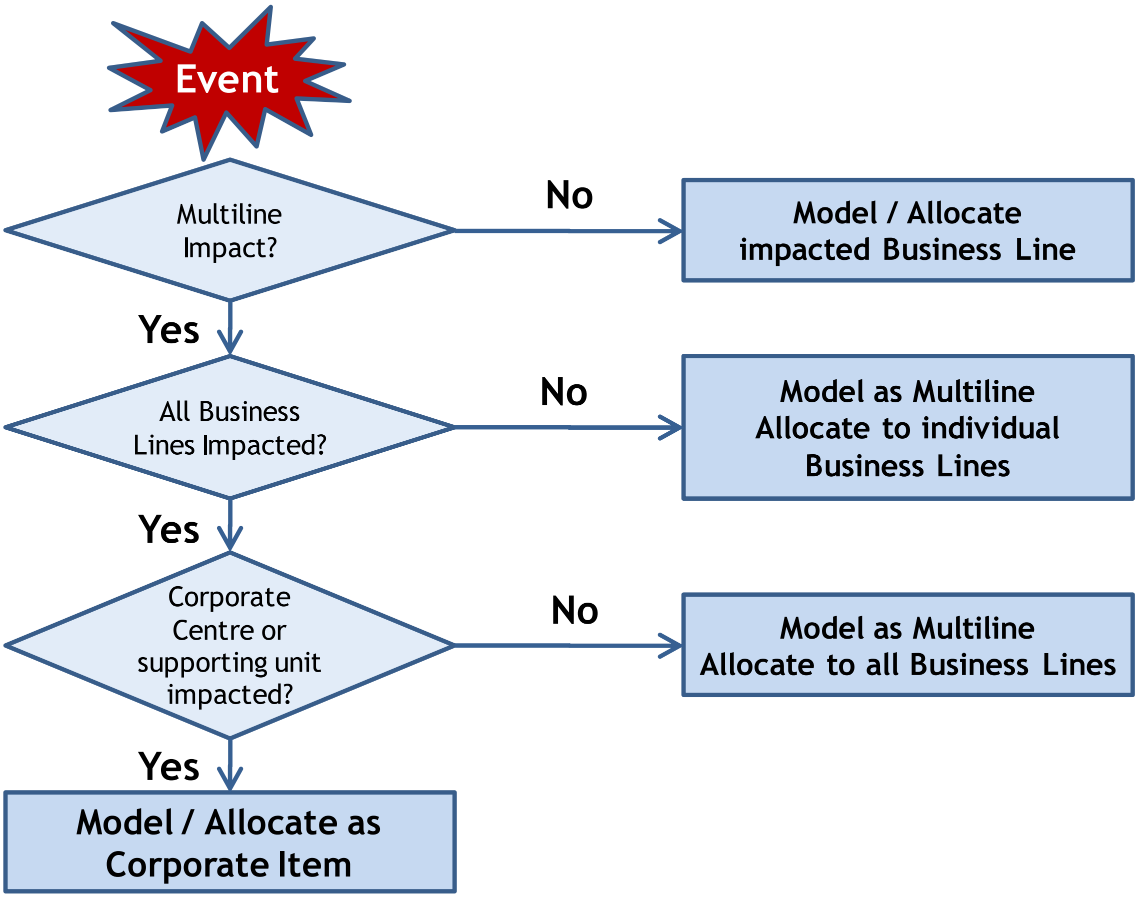


Figure 1 - Decision Tree for Mapping Corporate Items

See Section 3.2.1 Grouped Losses for an Example of Relationship between Grouped, & Linked Losses

5.1.2 EVENTS AFFECTING MULTIPLE BUSINESS LINES

Requirement: A loss affecting multiple business lines must be reported to ORX as linked losses using a common reference code.

In some cases, Operational Risk events impact more than one Business Line. ORX Members should attempt to assign each event to a single business, based on degree of impact, etc. But, where an infrastructure or similar event impacts significantly different businesses, separate records should be submitted for each line of business impacted. The "related events" field will be used to indicate which records are linked by including a common internal reference (this will be converted by the Administrator into a different code when stored in the ORX database to maintain confidentiality)[1].

All individual events being part of a grouped event must be classified within the same event type category. For each Related Event ID only one record is allowed for per level 2 BL/ET combinations i.e. member banks must aggregate multiple records in a single level 2 BL/ET combination before submission.

Please note the mapping of one internally reported event allocated to one internal Business Line must not lead to multiple ORX-Business Line recordings of single events.

5.1.3 MATERIALITY

Requirement: The trigger for separately mapping an activity to a Business Line Level 2 begins when the Number of Losses is equal to or regularly exceeds 1% in a quarterly data delivery. Having begun to map the activity to the Level 2 Business Line then it must continue in future data deliveries. Changes to historical data are not required.

It is expected that this test will be applied annually or whenever there is a reorganisation, for example business acquisition.

Background: It is expected that some degree of sub-allocation will be needed between the firm's business units and ORX Business Lines Level 2. It is unreasonable to expect that every loss is mapped exactly to every ORX Business Line Level 2. In addition to the losses, this would also have implications for the mapping of Gross Income. As a result a materiality test is required.

[1] Two sets of Loss Event Severity reports are delivered:

(a) reports including multi-impact events split by LOB, and

(b) a new set of reports in which events impacting more than one LOB are combined into a single record, with the resulting LOB called "Multi-Impact."

This allows event-level modelling of such items and later allocation based on businesses impacted.

Table 1 – Business Lines Type Level 1 & 2 – Basel & ORX

Business Unit	**Basel Business Lines**		**ORX Business Lines**			
	Level 1	**Level 2**	**Code**	**Level 1**	**Code**	**Level 2**
Investment Banking	Corporate Finance	Corporate Finance Municipal / Government Merchant Banking Advisory Services	BL01	Corporate Finance	BL0101	Corporate Finance
					BL0102	Municipal / Government
					BL0103	Advisory Services
	Trading & Sales	Sales Market Making Proprietary Positions Treasury	BL02	Trading & Sales	BL0201	Equities
					BL0202	Global Markets
					BL0203	Corporate Investment
					BL0204	Treasury
Banking	Retail Banking	Retail Banking Card Services Private Banking	BL03	Retail Banking	BL0301	Retail Banking
					BL0302	Card Services
			BL09	Private Banking	BL0901	Private Banking
	Commercial Banking	Commercial Banking	BL04	Commercial Banking	BL0401	Commercial Banking
	Payments & Settlements	External Clients	BL05	Clearing	BL0501	Cash Clearing
					BL0502	Securities Clearing
	Agency Services	Custody Corporate Agency Corporate Trust	BL06	Agency Services	BL0601	Custody Services
					BL0602	Corporate Trust & Agency
Other	Asset Management	Discretionary Fund Mgt Non-Discretionary Fund Mgt	BL07	Asset Management	BL0703	Fund Mgt

Business Unit	Basel Business Lines		ORX Business Lines			
	Level 1	**Level 2**	**Code**	**Level 1**	**Code**	**Level 2**
	Retail Brokerage	Retail Brokerage	BL08	Retail Brokerage	BL0801	Retail Brokerage
			BL10	Corporate Items	BL1001	Corporate Items

Note: the following changes from ORRS 2007 have been implemented

- Merge **Agency Services / Custom Services** BL0603 into BL0602 **Agency Services / Corporate Trust & Agency**

5.2 EVENT TYPES

Definition: Event Types represent a description of what happened. The Event Types used by ORX are close as possible to the intent of the Basel Committee, but not exactly the same.

The principal requirement for ORX event classification is to support consistency, according to agreed rules and definitions. Several means may be available to support the classification process (decision trees, types, etc.).

Essentially the Event Type label is a response to the question “What happened to give rise to this Operational Risk loss?” Why it happened would be part of causal analysis and outside the scope of the Event Types.

Requirements: ORX requires the allocation of *all Operational Risk events* to a Level 2 Event Type.

Table 2 - Comparison of Basel and ORX Event Type Grids

Basel		**ORX**			
Level 1	**Level 2**	**Code**	**Level 1**	**Code**	**Level 2**
Internal Fraud	Unauthorised Activity Theft & Fraud	EL01	Internal Fraud	EL0101	Unauthorised Activity
				EL0102	Internal Theft & Fraud
				EL0103	System Security Internal– Wilful Damage
External Fraud	Theft & Fraud ext Systems Security	El02	External Fraud	EL0201	External Theft & Fraud
				EL0202	System Security External – Wilful Damage
Employee Practices & Workplace Safety	Employee Relations Safe Environment Diversity & Discrimination	EL03	Employee Practices & Workplace Safety	EL0301	Employee Relations
				EL0302	Safe Workplace Environment
				EL0303	Employment Diversity & Discrimination
Clients, Products & Business Practices	Suitability, Disclosure & Fiduciary Improper Business or Market Practices Product Flaws Selection, Sponsorship & Exposure Advisory Activities	EL04	Clients, Products & Business Practices	EL0401	Suitability, Disclosure & Fiduciary
				EL0402	Improper Business or Market Practices
				EL0403	Product Flaws
				EL0404	Selection, Sponsorship & Exposure
				EL0405	Advisory Activities
Damage to Physical Assets	Natural Disasters	EL05	Disasters & Public Safety	EL0501	Natural disasters & Other Events
				EL0502	Accidents & Public Safety
				EL0503	Wilful Damage & Terrorism
Business Disruptions & System Failures	Systems	EL06	Technology & Infrastructure Failures	EL0601	Technology & Infrastructure Failures

Basel		**ORX**			
Level 1	**Level 2**	**Code**	**Level 1**	**Code**	**Level 2**
Execution, Delivery & Process Management	Transaction Capture, Execution & Maintenance Monitoring & Reporting Customer Intake & Documentation Customer / Client Account Mgt Financial Counterparty Event Vendor Event	EL07	Execution, Delivery & Process Management	EL0701	Transaction Capture, Execution & Maintenance
				EL0702	Monitoring & Reporting
				EL0703	Customer Intake & Documentation
				EL0704	Customer / Client Account Mgt

Note: the following changes from ORRS 2007 have been implemented:

Step 1

- Merge Internal Fraud / Internal Systems Security (for profit) EL0103 with EL0102 to form new EL0102 Internal Fraud / Internal Theft & Fraud
- Merge External Fraud / External Systems Security (for profit) EL0202 with EL0201 to form new EL0201 External Fraud / External Theft & Fraud
- Rename Disasters & Public Safety EL0501 to include the word Natural

Step 2:

- Move Malicious Damage / Wilful Damage and Terrorism EL0801(2007) to become EL0503 Natural Disasters & Public Safety / Wilful Damage and Terrorism
- Move Malicious Damage / Systems Security – Wilful Damage Internal EL0803(2007) to become newEL0103 Internal Fraud / System Security Internal– Wilful Damage
- Move Malicious Damage / Systems Security - Wilful Damage External EL0802(2007) to become new EL0202 External Fraud / System Security External – Wilful Damage

5.3 PRODUCT TYPES

Definition: Products, which also include services, are the sources of revenue for a bank via direct or indirect fees.

The general objective of the product type attribute is to:

- increase the understanding of the nature of losses and
- facilitate an improvement in transparency within a Member
- link losses to products for P&L and budget purposes
- identify chronic or recurring weaknesses, and
- promote value-added dialogue with the businesses and functional areas regarding the impact of their Operational Risk experience and potential Operational Risk exposure

Requirements: ORX requires the classification of *all Operational Risk events* against Level 2 of the product type. Whether to classify a certain loss to a specific product type depends on what product or service was involved when the event happened.

If revenue streams from multiple products were affected then use the one single product type to which the event contributing the bulk of the Gross Loss can be attributed. If no single product was involved or where the event was so widespread that specifying individual products would no longer be relevant or would add little or no value, then classify these losses as 'not product related' (e.g. branch or ATM robberies, natural disaster etc.).

Examples – Included in Reporting to ORX

- Activities carried out by a bank, e.g. accepting and paying cheques, safekeeping of assets, administration of third party investment funds;
- Tools provided by a bank, e.g. internet banking, ATMs/ABMs, online wire transfers; debit cards;
- Support/facilitation of client activities, e.g. loans, principal or agent positions for client trades; providing advice; lending securities.

5.3.1 BUNDLED PRODUCTS

Definition: Bundled Products occur in two situations and are defined as follows:

- A bank puts together a bundle or package of products or services; a single fee is charged for the whole bundle. Some of the products included in the bundle may also be available on a standalone basis and can be purchased individually.
- A product which is offered on a standalone basis by one bank is provided as an adjunct or incidental service in association with a 'primary' product by another bank.

Requirement: Products and services should be reported on a standalone basis at the most granular level provided by the categories in the Product Type Attribute. To determine the appropriate Product Type category, Members must identify whether the loss involved a single or dominant product within the bundle or package of services.

Examples – Included in Reporting to ORX

- ‘Enhanced banking package’ composed of a chequing account, a savings account, a safe deposit box, a credit card, a line of credit and electronic banking available for €20 per month.
- Bank A offers custody services as a standalone product; Bank B offers prime brokerage services which include custody.
- Bank J provides custodial services to institutional clients; this includes handling of corporate actions. Bank Q provides services related to corporate actions on an outsourced basis to other financial institutions. In the event of a loss involving a corporate action, the appropriate Product Type category for both banks is PD0802 Corporate Actions Services (Trust/Investment Management)

To support Members and promote consistency when addressing bundled products a series of decision trees have been developed (see Appendix).

Table 3 - Product Type Level 1 Labels – Overview

PD0100	Capital Raising	Structuring, issuance or placement of securities and similar instruments, not just for capital raising
PD0200	Corporate Finance Services	Advisory Services regarding corporate structure and strategic decisions
PD0300	Derivatives & Securities	Trading & Sale of all securities and derivatives either via an exchange or over-the-counter.
PD0400	Retail Credit	Financing and related services
PD0500	Commercial Credit	Financing and related services
PD0600	Deposits	Bank account, deposit services, "plain vanilla" investment products
PD0700	Cash Management, Payments & Settlements	Client management of cash inflows/outflows; all forms of payments; clearing, settlement and exchange services
PD0800	Trust / Investment Management	Various services related to administration and management of estates, trusts, assets, portfolios etc.
PD0900	Investment Products	Investment management, execution, administration, operational management services
PD1000	Brokerage	Investment advisory, management and execution services
Other		
PD9800	Non-Banking Product	Other products/services not generally considered part of a bank or investment bank's offering, e.g. insurance
PD9900	Not Product Related	Used for situation not involving products or services.

5.4 PROCESS TYPES

Definition: A business process is as a set of coordinated tasks and activities that will lead to accomplishing a specific organisational goal; i.e. a sequence of interdependent and linked procedures which consume one or more resources (employee time, energy, machines, money) to convert inputs (data, material, parts, etc.) into outputs. For classification purposes ORX defines two sets of process groups.

The general objective of the process type attribute is to:

- increase the understanding of the nature of losses and
- facilitate an improvement in transparency within a Member
- identify sources of loss concentrations
- identify chronic or recurring weaknesses, and
- promote value-added dialogue with the businesses and functional areas regarding the impact of their Operational Risk experience and potential Operational Risk exposure.

Requirement: ORX requires the classification of *all Operational Risk events* against Level 1 of the process types to be performed as follows:

Assign the (first) process type that was being performed / impacted when the Operational Risk event (not the OR loss!) occurred:

- consider which stage of the transaction/value cycle was being completed;
- only if the transaction / value cycle was NOT impacted then consider which aspect of corporate activity was taking place.

Where multiple processes were affected simultaneously, select the process step to which the event contributing the bulk of the Gross Loss can be attributed. Where no process was involved or where the event was so widespread that specifying individual processes would no longer be relevant or would add little or no value, a classification as ‘not process related’ (e.g. branch or ATM robberies, natural disaster etc.) is allowed.

A second level of process types exists to support consistent allocation within Members, but is not implemented at ORX at this time

ORRS Updates:
ORX ORRS Update - (IE0013) Payment Protection Insurance (Rec) 7 May 10.Doc
ORX ORRS Update - (0024) Selecting Process Type (Prop) 26 Aug 10.doc
ORX ORRS Update - (0026) Process PC0600 Stream-3 (Draft) 12 Aug 10.doc

Figure 2 - Diagram of Transaction Life Cycle and Corporate Activities

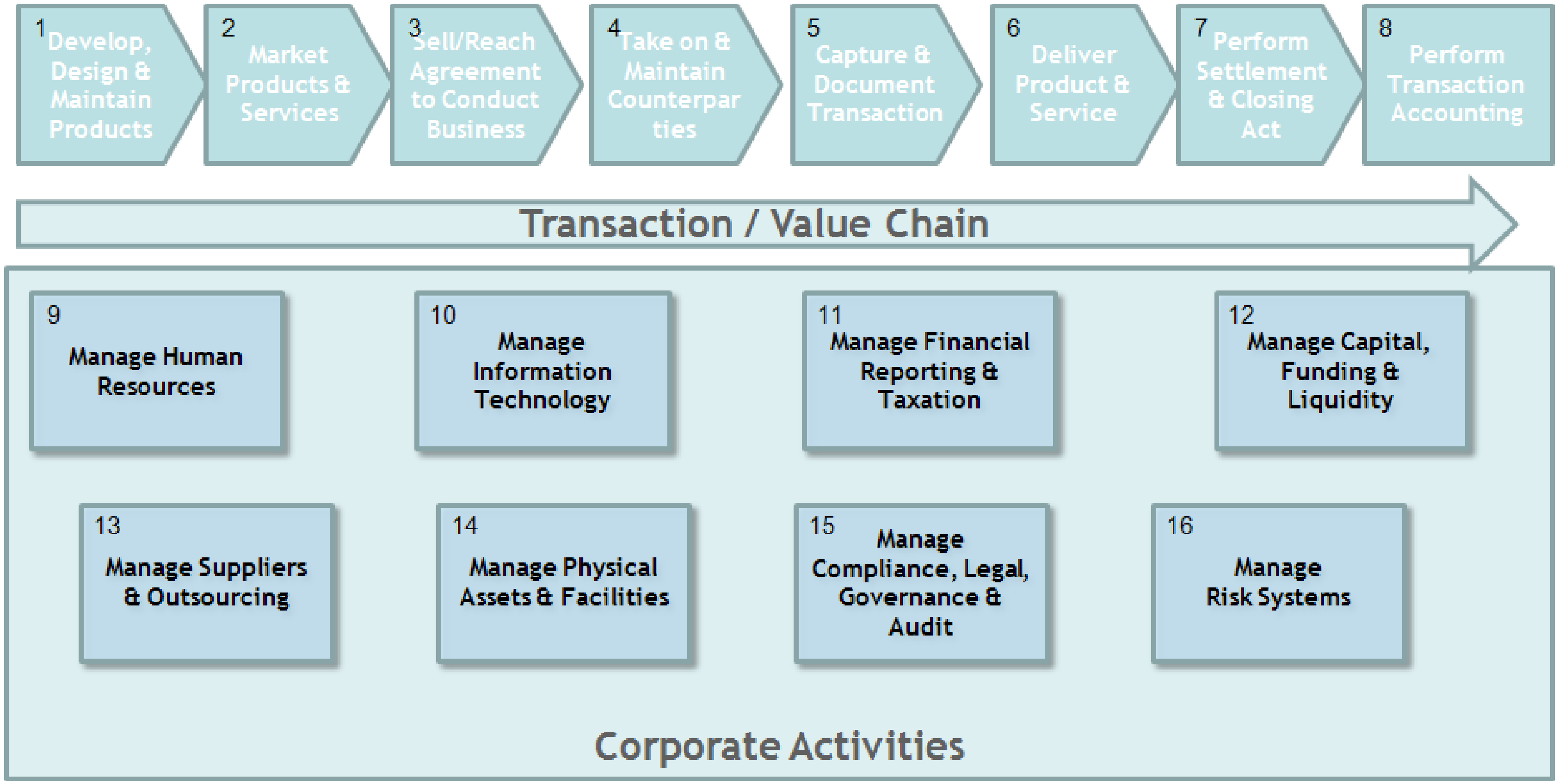


Table 4 - Process Type Level 1 Labels – Detailed

Transaction Life Cycle		
PC0100	Develop, design, and maintain Products or Services	Indentify, design, produce and maintain new financial products, services and business capabilities, including the models and methodologies upon which they are based.
PC0200	Market Products or Services	Promote the firm and/or its products and services through general marketing or advertising, including the production of standard fees, rates, changes and prices for specific products and services.
PC0300	Sell or reach agreement to conduct specific business	Sell of offer specific products and / or services of the firm in discussions with individual clients, including the quotation of firm or indicative fees, rates, charges or the like with the intent of concluding a specific deal for specific product sales or service delivery.
PC0400	Take on and maintain Counterparties	“On-Board” and maintain client or counterparty accounts, including related due diligence, data and documentation.
PC0500	Capture and Document Transactions	Record transaction specific terms and instructions in the processing systems of the firm; also produce related transaction documents.
PC0600	Deliver Products or Services	Deliver or fulfil agreed-upon products / services, including set-up and maintenance of transactions and required arrangements and agreed-upon non-transaction financial services (trust administration, financial advisory services, sale of research as a product, etc.)
PC0700	Perform Settlements and Closing Activities	The definitive exchange or transfer of assets, currency or other property (commonly in exchange for value) and related transactional mechanics.

PC0800	Perform Transaction Accounting	Record transaction and/or position information in the firm's accounting records / general ledger.

Corporate Activities

PC0900	Manage Human resources	Manage human resources, apart from direct business management functions
PC1000	Manage Information Technology	Acquire or design / develop information technology and implement related security and incident response measures.
PC1100	Manage Financial Reporting & Taxation	Perform financial reporting and control, based on (but not including) books and records or general ledger entries made during *Transaction Accounting*.
PC1200	Manage Capital, Funding & Liquidity	Manage the firm's capital account, liquidity and balance sheet.
PC1300	Manage Suppliers and Outsourcing Service Suppliers	Selection, on-boarding, management and oversight of third party vendors and outsourcing service providers.
PC1400	Manage Physical Assets & Facilities	Provision and management of physical facilities, equipment and safe workplace environment.
PC1500	Manage Audit, Compliance, Governance and Legal	Establish and maintain the firm's policies, standards, procedures, codes of conduct and associat4ed compliance controls and testing procedures.
PC1600	Manage Risk Systems	Establish risk management processes and methodologies (apart from standard business process and supervisory controls) to record, monitor, evaluate, control or manage risk exposures within the firm.

Other

PC9900	Not Process Related	Used for situation where no specific process was involved, include multiple processes, but none dominant.

5.5 LARGE LOSS EVENT ATTRIBUTES

Definition: Large Losses reported to ORX are to have additional information. The additional descriptions include:

1. Alleged Causes
2. Jurisdiction / Choice of Law
3. Counterparty / Claimant Type
4. Role of the Firm
5. Environmental Volatility

A Large Loss is defined as a single or Grouped Losses whose Gross Loss is equal to or larger than €10,000,000.

The objective of this additional information is to:

- Increase the understanding of the nature of losses
- Improve the ability of Members to select relevant external losses for:
  - Scenarios and Risk &Control Self-Assessments
  - Inclusion in capital calculations or validation of capital estimates
  - Benchmarking businesses and functional areas regarding the impact of potential Operational Risk exposure.

Requirements: ORX requires the Large Loss Attributes to be provided at Level 2 for *all large loss events*.

While the Alleged Cause may be the result of opinion, possibly supported by a decision tool such as root cause analysis, the other Large Loss Attributes are statements of fact, for example the role of the firm.

Due to the possible interaction between various Alleged Causes, firms may report 1 to 3 selections for this sub-category.

Table 5 - Large Loss Attributes Level 1 Labels – Overview

Alleged Causes

CS0100	External
CS0200	People / Staff
CS0300	Governance & Structure
CS0400	Processes
CS0500	Internal Systems Failure

Other Large Loss Attributes

LS0100	Jurisdiction / Choice of Law
LS0200	Counterparty / Claimant Type
LS0300	Role of the Firm
LS0400	Environmental Volatility

5.6 COUNTRY CODES

Definition: Country Codes identify where the country OR Loss occurred.

The geographical location of where the loss occurred is not necessarily where the loss is booked.

When reporting data back to ORX Members the individual country codes are grouped to form regions. These regions have critical mass to reduce the likelihood that an individual Member can be identified.

ORX uses the 2 letter country code as provided by ISO and used elsewhere in bank systems. http://www.iso.org/iso/country_codes/iso_3166_code_lists.htm

Requirement: ORX requires the provision of an ISO two letter country code against *all Operational Risk events*.

Examples

- A Japanese client sends an order to Hong Kong for execution of an order in a US Stock on the New York Stock Exchange. There is an Operational Risk event. The firm should book the loss in Hong Kong or the USA depending upon where the loss occurred.
- A project taking place in Chile is being undertaken by a German company with funding in the form of loans in US $ from the London Office of the bank.

There is a mis-estimation of interest due by the firm, not the borrower. The loss occurred in London so the UK Country Code should be used.

6. HOW TO REPORT EXPOSURE INDICATORS

Exposure Indicators are used to normalise Loss data, for example €XX Losses per €100 Gross Income. As a result, the Exposure Indicators are a key element of the data submissions and utility of reports to Members. Without the Exposure Indicators it is difficult to benchmark the performance of an individual Member to all of the Members.

6.1 GROSS INCOME

Definition: Gross Income in the context of OR has been defined in detail in the scope of application of the Basel II Accord (e.g. Standardized Approach) in line with local accounting principles. All members are allowed to follow the respective accounting principles when reporting to ORX. Generally, Gross Income is: net interest income + net non-interest income. Net non-interest income is generally composed of:

(i) fees and commissions receivable less fees and commissions payable,
(ii) the net result on financial operations, and
(iii) other income.

Gross Income is provided by third parties not other parts of the group as a reallocation of costs.

This measure is gross of any provisions (e.g. for unpaid interest). The reported Gross income figure excludes extraordinary or irregular items and income derived from insurance. Realized gains/losses from the sale of securities held in the banking book are also to be excluded from gross income. Banks may report Gross Income and its components according to the GAAP standards of their home country.

Requirement: The following general rules apply for Gross Income calculation to be reported quarterly to ORX as part of the exposure indicators:

- ORX Members will report Gross Income figures according to their local accounting principles and consistent with the scope of application of the Basel II Accord.
- ORX Members will report total Gross Income for Business Lines for which data submissions are scheduled to be made.
- Gross Income will be reported only for those parts of the organization for which data submission is made. Gross Income for Corporate Centre activities must be allocated to the reported ORX business lines.

- ORX Members will report quarterly Gross Income figures (not year-to-date figures).

It is recognised that for some firms the Gross Income figure is not known at the time that the data submission is made to ORX. Under these circumstances an estimate can be provided and corrected as part of a later data submission. The estimates or corrections should relate to the level of activity and not simply be a 6 month figure divided by 2.

6.2 SECTOR DATABASE EXPOSURE INDICATORS

Sector databases, for example Investment Banking or Canadian, may also use Gross Income or alternative or additional Exposure Indicators. These alternative or additional Exposure Indicators will be specified and documented by the working group overseeing the activities of that sector database.

7. TECHNICAL ISSUES: THRESHOLD, HISTORY, COVERAGE, ETC

Data submission to ORX is made on a quarterly basis. Each time there is a data reporting cycle detailed templates and reporting instructions will be provided by ORX. For each data submission Members will produce and send their data since their first reporting date (for example January 2002 for founding Members). Members are expected to report their full loss data history.

ORX is aware that all Banks are constantly reviewing and refining their internal processes for capturing and categorising Operational Risk losses/events. As a consequence of this refinement, Members are allowed to modify and/or update their previously reported events.

7.1 REPORTING GROSS LOSS THRESHOLD

Requirement: Members are required to report all losses where the gross loss is equal to or greater than €20,000 as an individual event or an aggregate event amount.

Background: The ORX Board fixes the threshold amount of an event to be reported to ORX. The threshold applies to the Gross Loss (see Section 4 – Determine the Gross Loss). At present, the amount is € 20,000 (loss/event aggregate amount).

Internally, some ORX members may use a lower threshold to aggregate many small events into a single periodic record, often for reconciliation purposes. Such aggregated records are not reportable to ORX, even if their aggregate total exceeds the applicable reporting threshold then in effect.

7.2 TIME PERIOD

Requirement: The quarterly submission relates to all events recognized during a given quarter (this is in addition to reporting historic data). For example, all losses above the threshold occurring in January must be reported to ORX in the immediately following reporting cycle. Exceptions to this complete reporting relate to legal concerns.

Reporting periods will be quarterly. A reporting quarter is defined as: January through March; April through June; July through September; and October through December.

Quarterly reporting will be for the previously completed quarter. Quarterly reporting is performed during a two week window after at least six weeks of the previous quarter end. For example, for 2012 first quarter data was reported 21st May – 1st June.

7.3 CONSOLIDATED REPORTING

If the reporting entity has an equity investment or ownership of a financial services entity, that is less than 100%, then reporting losses to ORX is <u>not required</u>. The overall materiality of reporting for entities, where there is less than 100% ownership, is not known and consideration of practical issues need to be taken into account before this becomes a requirement. If there are any doubts then these should be raised with the Definitions Working Group.

For Members wishing to report losses for these entities there are two criteria:

1. The legal entity must be a "bank" or a "securities company" or an "asset management company". Insurance companies are excluded. Or the legal entity must be performing a service for the bank that is integral to banking. Examples include activities that are "offshored".
2. The balance sheet and P&L of the subsidiary must be consolidated with the reporting entity. As a result, it is generally understood that OR losses of banks where the reporting entity has less than 50% ownership are not reported to ORX.

Members wishing to report losses for entities that are less than 100% owned also need to ensure that the impact is not double counted, for example once in the value of the investment and then again in capital calculations.

7.4 EXCEPTIONS TO COMPLETE REPORTING

Requirement: Members are required to report losses for their complete range of banking activities and complete geographic coverage of those activities.

Upon joining ORX a new Member may have difficulties in providing data of the appropriate quality across its full range of activities and locations. Under these circumstances the Member is required to report only for those activities and locations that meet the quality standards.

Members may find that a newly acquired business unit does not meet the quality standards. Under these circumstances the Member is expected to keep reporting the loss data that does meet the quality standards and at a later date add the data from the new business unit.

There must be alignment between the scope of reporting losses and the Exposure Indicators. For example, if a Member is not reporting losses for the USA then the reported Exposure Indicator must exclude values for the USA. Or if a Member is not reporting losses for BL0201 (Equities) then the Exposure Indicator reported for Trading & Sales (BL0200) must exclude the Exposure Indicator values for BL0201.

Members reporting for part of their activities or some of their locations are expected to have plans to enable them to provide a complete and comprehensive submission to ORX.

7.5 SUBMITTING HISTORICAL DATA

New historical data due to joining of new members, mergers or acquiring of new Business Units will be submitted in historical data cycles to ensure a critical mass for confidentiality reasons. During a historical data cycle the members are requested to submit all their data in accordance with these guidelines. The critical mass consists of 4 banks. ORX informs the members, whether a cycle is a historical data cycle or not.

7.6 EFFECTS OF ACQUIRING OR DISPOSING OF BUSINESS UNITS

During the course of business, an ORX member may decide to acquire a new activity (LoB) or sell an existing one (e.g. Joint Ventures, new acquired or sold subsidiary). In those cases members must report to ORX as follows:

- Buying a new Business Unit
  1) If the acquired BU keeps historical data & exposure indicators with sufficient quality, then data will be simply consolidated.

     If an acquired unit has credible pre-acquisition loss data, it could be included in ORX; if not, reporting should start as of acquisition date.

     To avoid double counting, a member should not add pre-acquisition loss history of an acquired entity, in case this entity was acquired from another ORX member.

     Future exposures (lawsuits, etc.) resulting from actions taken by an acquired entity before purchase are reportable to ORX as they arise (in general, one buys the latent legal liabilities of a firm when it is purchased)

  2) If the acquired BU does not keep such data, then the reporting will start consolidating data when capturing procedures are in place with the required ORX quality level.

- Selling an existing BU

  If a bank sells a BU, any past losses as well as already submitted exposure indicators attributed to it shall remain in that bank's data submission. Additionally, any events whose recognition date is after the decision to sell should be submitted. This includes events occurring after the effective sale date. Depending upon the terms of the sale, the vendor may indemnify the buyer for certain types of losses for a given period of time. An example might be fraud that began before the sale but was only found after the sale. As a result of the indemnification the selling bank is experiencing the OR loss.

7.7 SUBMITTING LOSSES FOR A NEW BUSINESS LINE

When an existing ORX member starts a new business in a Business Line that he has not already reported (e.g. Acquiring of new Business Units or subsidiaries, Extending Business) the new business unit rules of Section 7.6 apply accordingly.

In addition the member informs ORXS about the new Business Line and starts to submit the collected data (loss data and Exposure Indicators) in the next data cycle. In case of historical data the specific rules of Section 7.5 apply.

7.8 STOPPING REPORTING FOR AN EXISTING BUSINESS LINE

For several reasons (Selling BUs, Business Reorganisation, etc) a member may have the situation that stops his activities in an already reported Business Line. The member has to ensure that no new losses can occur in that Business Line. Informs ORXS and does not report any new losses or exposure indicators attributed to that Business Line. Any past losses as well as already submitted exposure indicators attributed to it shall remain in that bank's data submission.

7.9 MERGERS BETWEEN MEMBERS

During the course of business, an ORX member may decide to merge with another existing ORX member. In those cases:

- ORX will consolidate the pre-merger data of the two merging members in its database.
- Member will consolidate its data with the pre-acquisition loss history of the acquired member and submit for historical data cycles only.

For non-historical data cycles the acquiring member should only report post-acquisition loss data. If the acquired BU does not keep such data, then the reporting will start consolidating data when capturing procedures are in place with the required ORX quality level.

7.10 LEAVING ORX

When a Member leaves ORX its data stays with ORX and continues to be part of the data set reported to current Members.

Under the Articles of Association a Member does not have the right to withdraw all or part of the data reported to ORX. Further, ORX can continue to use the data for reporting to current Members. This promotes consistency in the time series so that historic data does not suddenly disappear when a Member leaves and it protects the anonymity of the Member leaving.

ASSOCIATION

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