



Guidance Note:

Prudential Reporting of Operational Risk

Comprising guidance relating to reporting under:

- › **Basic Indicator Approach to Operational Risk (BIA)**
- › **Standardised Approach to Operational Risk (SAO)**

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1 Introduction

- 1.1 This document should be read in conjunction with the relevant sheets in the JFSC's Prudential Reporting template, being:
 - 1.1.1 Sheet '4.1 BIA'
 - 1.1.2 Sheet '4.2 SAO'
- 1.2 The purpose of this document is to provide an overview of that module and, through the provision of detailed notes and examples, enable JIBs to correctly complete it.
- 1.3 Operational risk is defined by the JFSC as the risk of loss resulting from:
 - 1.3.1 Inadequate or failed internal processes and systems
 - 1.3.2 The actions of people; or
 - 1.3.3 External events.

The BCBS has stated that this definition includes legal risk, but excludes strategic and reputational risk.
- 1.4 Each approach (BIA or SAO) has an associated reporting Sheet that must be used to derive the operational risk capital requirement, a calculation based on income data from the past three years. JIBs should only complete the form relevant to the approach agreed between them and the JFSC.

2 Definition of year of operation

- 2.1 Under the BIA and SAO, the reporting deposit taker's capital charge for operational risk is calculated using gross income data from the last three years.
- 2.2 The Risk Weighted Assets (**RWA**) "equivalent amount" is derived by multiplying the capital charge by 12.5. This is combined with the RWA derived for credit risk and other risks to arrive at the total RWA of the registered person.
- 2.3 A JIB should treat any partial year of operation of six months or more as a full year. Any partial year of operation of less than six months should be disregarded.
- 2.4 If any partial year is counted as a full year, the gross income of that partial year should be annualised.
- 2.5 An illustration of calculating the gross income and advances in the retail and commercial banking business lines for partial and full years of operation is shown in **Appendix A**.

3 Guidance on Form Completion

General layout of module

- 3.1 The relevant sheets within the Prudential Return, are:
 - 3.1.1 BIA: '4.1 BIA'; and
 - 3.1.2 SAO: '4.2 SAO'
- 3.2 The reporting JIB will have agreed with the JFSC which approach it will use. Completed examples of each form are included in Appendix C and Appendix D respectively.
- 3.3 The method used (BIA or SAO) is required to be entered on the Submission Header sheet, in the row 'Operational Risk Method'. Section A of each sheet confirms that data has not been entered on an incorrect sheet – FALSE will be displayed in red if this is the case.

'4.1 BIA'

- 3.4 The capital charge for operational risk under the BIA is calculated as 15% (the "Alpha" factor) of the average gross income over the past three years, ignoring those years where income was not positive.

Section B: Income

Item	Definition
B.1	Net Interest Income. Interest Income net of Interest Expense for each of the three preceding years.
B.2	Net Non-Interest Income. Net non-interest income for each of the three preceding years. Note that this is gross of exceptional items and operational costs.

Sections C and D

Item	Definition
C.1	Average Income, where positive. Calculated as the sum of B.1 and B.2, for each year where the said sum was positive, divided by the number of those years.
D.0	BIA Requirement. The capital charge for the BIA is calculated as 15% of Average Income. The RWA equivalent for the BIA is calculated by multiplying the capital charge by 12.5.

'4.2 SAO'

- 3.5 The SAO requires the deposit taker to allocate income by business line for each of the previous three years. Multiplying these income amounts by the appropriate scaling factor for that business line (the "Beta") gives the capital charge for each of these lines. Adding together the capital charges of each line gives the total charge for a year. Beta varies from 12% to 18%, as specified in Basel II. The RWA equivalent is derived from the average of these yearly capital charges, ignoring those where the capital charge derived is not positive.

Section B: Income:

Item	Beta	Item Name	Definition
B.1	18%	Corporate Finance	<ul style="list-style-type: none"> › Net fees and commission earned.
B.2	18%	Trading & Sales	<ul style="list-style-type: none"> › Profits/losses on instruments held for trading purposes, net of funding costs. › Fees from wholesale broking.
B.3	12%	Retail Banking	<ul style="list-style-type: none"> › Net interest income on advances to retail customers and small businesses treated as retail. › Fees related to retail activities. › Net income from swaps and derivatives held to hedge the retail banking book. › Income on purchased retail receivables.
B.4	15%	Commercial Banking	<ul style="list-style-type: none"> › Net interest income on advances to corporate, bank and sovereign customers. › Income on purchased corporate receivables. › Fees related to commercial banking activities including commitments, guarantees and bills of exchange. › Net income on securities held in the banking book. › Profits/losses on swaps and derivatives held to hedge the commercial banking book.
B.5	18%	Payment & Settlement	<ul style="list-style-type: none"> › Net fees/commissions earned. › Fees for provision of payments/settlement facilities for wholesale counterparties.
B.6	15%	Agency Services	<ul style="list-style-type: none"> › Net fees and commission earned.
B.7	12%	Asset Management	<ul style="list-style-type: none"> › Net fees and commission earned.
B.8	12%	Retail Brokerage	<ul style="list-style-type: none"> › Net fees and commission earned.

3.6 All income of the bank must be allocated to a business line. If there is any doubt as to appropriate allocation please refer to the relevant Supervision Manager at the Commission.

Sections C and D:

Item	Definition
C.1 to C.8	<p>For each component item (C.1 to C.8), the capital charge is calculated as:</p> <ul style="list-style-type: none"> › the income reported in Section B multiplied by › by the appropriate Beta for each business line to get the charge for that line



C.0	Total - Capital charge. The total charge (C.0) is calculated by adding together the eight capital charges thus calculated for the business lines (C.1 to C.8). In any given year, positive capital charges for any individual lines may be offset by negative capital charges for other business lines in that year.
D.0	SAO Requirement. Calculated as 12.5 multiplied by the average yearly capital charge: the sum of the three yearly capital charges (C.0), where positive, divided by the number of those years

Appendices

A. Examples of full and partial year treatments

Example 1: Three or more full years

A.1 If a JIB:

- A.1.1 Had an accounting year that matched the calendar year;
- A.1.2 Had commenced operations in Jersey prior to 1/1/2017; and
- A.1.3 Wished to report for Q4 2019, or any of the first three quarters in 2020, then:
 - › “Last Year” would be 2019: report full year’s gross income.
 - › “1 year prior” would be 2018: derived in equivalent fashion to “Last Year”.
 - › “2 years prior” would be 2017.

Example 2: One full year plus one year of more than six months duration.

A.2 If a JIB:

- A.2.1 Had an accounting year that matched the calendar year;
- A.2.2 Had commenced operations in Jersey on 1/4/2018; and
- A.2.3 Wished to report for Q4 2019, or any of the first three quarters in 2020, then:
 - › “Last Year” would be 2019: report full year’s gross income.
 - › “1 year prior” would be 2018: annualise this partial year’s gross income; in this case by dividing by nine (number of months of operation) and multiplying by twelve.
 - › “2 years prior” would be 2017: report zero for gross income. The calculation disregards these figures.

Example 3: Two full years plus one year of less than 6 months duration.

A.3 If a JIB:

- A.3.1 Had an accounting year that matched the calendar year; and
- A.3.2 Had commenced operations in Jersey on 1/9/20017

A.3.3 Wished to report for Q4 2019, or any of the first three quarters in 2020, then:

- › “Last Year” would be 2019: report full year’s gross income.
- › “1 year prior” would be 2018: derived in equivalent fashion to “Last Year”.
- › “2 years prior” would be 2017: report zero for gross income. The calculation disregards these figures.

B. Example data

Introduction

B.1 The example data given in the tables below has been used to complete the form overleaf for illustrative purposes.

B.2 Whilst the form has been completed for both options (Appendix C and Appendix D), in practice the form would only be completed for the option that the JIB had agreed, with the form left blank for the other options.

Gross Income:

	2018		2017		2016	
Business Line	Net Interest Income	Net Non-Interest Income	Net Interest Income	Net Non-Interest Income	Net Interest Income	Net Non-Interest Income
Corporate Finance	0	1,200	0	1,100	0	1,000
Trading & Sales	0	2,000	0	-1,000	0	0
Retail Banking	5,000	-1,000	5,500	-1,000	6,000	-1,000
Commercial Banking	1,000	-2,000	-1,000	-3,000	0	0
Payment & Settlement	0	300	0	150	0	200
Agency Services	0	55	0	45	0	50
Asset Management	0	1000	0	-500	0	0
Retail Brokerage	0	1500	0	-500	0	0

C. Completed Form - BIA

Version 1

Item	Description	Consistency	Last year	1 year prior	2 years prior
A.1	Operational Risk Method	BIA			
A.2	Data points entered		2	2	2
A.0	Consistent	TRUE			
B.1	Net Interest Income		6,000	4,500	6,000
B.2	Net Non-Interest Income		3,055	(4,705)	250
B.0	Total Income		9,055	(205)	6,250
C.1	Average Income, where positive		7,653		
D.0	BIA Requirement		14,348		

D. Completed form - SAO

Version 1					
Item	Description	Consistency	Last year	1 year prior	2 years prior
A.1	Operational Risk Method	SAO			
A.2	Data points entered		8	8	8
A.0	Consistent	TRUE			
B.1	Corporate Finance - Income		1,200	1,100	1,000
B.2	Trading and sales - Income		2,000	(1,000)	-
B.3	Retail banking - Income		4,000	4,500	5,000
B.4	Commercial banking - Income		(1,000)	(4,000)	-
B.5	Payment and settlement - Income		300	150	200
B.6	Agency services - Income		55	45	50
B.7	Asset management - Income		1,000	(500)	-
B.8	Retail Brokerage - Income		1,500	(500)	-
B.0	Total - Income		9,055	(205)	6,250
C.1	Corporate Finance - Capital Charge		216	198	180
C.2	Trading and sales - Capital Charge		360	(180)	-
C.3	Retail banking - Capital Charge		480	540	600
C.4	Commercial banking - Capital Charge		(150)	(600)	-
C.5	Payment and settlement - Capital Charge		54	27	36
C.6	Agency services - Capital Charge		8	7	8
C.7	Asset management - Capital Charge		120	(60)	-
C.8	Retail Brokerage - Capital Charge		180	(60)	-
C.0	Total - Capital Charge		1,268	(128)	824
D.0	SAO Requirement		13,075		