



Bangko Sentral ng Pilipinas

OFFICE OF THE GOVERNOR

MEMORANDUM NO. M-2007-019

Series of 2007

**TO : All Universal and Commercial Banks, and their
Subsidiary Banks and Quasi-Banks**

**SUBJECT: Guidelines on the Use of the Standardized Approach
in Computing the Capital Charge for Operational Risks**

The Monetary Board, in its Resolution No. 651 dated 7 June 2007, approved the following guidelines for banks that intend to use the Standardized Approach (TSA) in computing the capital charge for operational risks under Circular No. 538 dated 4 August 2006.

Banks applying for the use of TSA must satisfy the following requirements/criteria:

General Criteria

1. The use of TSA shall be conditional upon the explicit prior approval of the BSP.
2. The BSP will only give approval to an applicant bank if at a minimum:
 - Its board of directors (or equivalent management committee in the case of foreign bank branches) and senior management are actively involved in the oversight of the operational risk management framework;
 - It has an operational risk management system that is conceptually sound and is implemented with integrity; and,
 - It has sufficient resources in the use of the approach in the major business lines as well as in the control and audit areas.
3. The above criteria should be supported by a written documentation of the Board-approved operational risk management framework of the bank, which should cover the following:

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- Overall objectives and policies
 - Strategies and processes
 - Operational risk management structure and organization
 - Scope and nature of risk reporting/assessment systems
 - Policies and procedure for mitigating operational risk
4. This operational risk management framework of the bank should be disclosed in its annual report, as provided under Circular No. 538.

Mapping of Gross Income

5. Banks using TSA in computing operational risk capital charge must develop specific written policies and criteria for mapping gross income of their current business lines into the standard business lines prescribed under Circular No. 538. They must also put in place a review process to adjust these policies and criteria for new or changing business activities or products as appropriate.
6. Banks must adopt the following principles for mapping their business activities to the appropriate business lines:
- Activities or products must be mapped into only one of the eight standard business lines, as follows:
 - a. Corporate finance

This includes banking arrangements and facilities (e.g. mergers and acquisitions, underwriting, privatizations, securitization, research, debt (government, high yield), equity, syndications, IPO, secondary private placements) provided to large commercial enterprises, multinational companies, non-bank financial institutions, government departments, etc.
 - b. Trading and sales

This includes treasury operations, buying and selling of securities, currencies and others for proprietary and client account.
 - c. Retail banking

This includes financing arrangements for private individuals, retail clients and small businesses such as personal loans, credit cards, auto loans, etc. as well as other facilities such as trust and estates and investment advice.

d. Commercial banking

This includes financing arrangements for commercial enterprises, including project finance, real estate, export finance, trade finance, factoring, leasing, guarantees, bills of exchange, etc.

e. Payment and settlement

This includes activities relating to payments and collections, interbank funds transfer, clearing and settlement.

f. Agency services

This refers to activities of the banks acting as issuing and paying agents for corporate clients, providing custodial services, etc.

g. Asset management

This includes managing funds of clients on a pooled, segregated, retail, institutional, open or closed basis under a mandate.

h. Retail brokerage

This includes brokering services provided to customers that are retail investors rather than institutional investors.

- Any activity or product which cannot be readily mapped into one of the standardized business lines but which is ancillary¹ to a business line shall be allocated to the business line to which it is ancillary. If the activity is ancillary to two or more business lines, an objective criteria or qualification must be made to allocate the annual gross income derived from that activity to the relevant business lines.
- Any activity that cannot be mapped into a particular business line and is not an ancillary activity to a business line shall be mapped into one of the business lines with the highest associated beta factor (18%). Any ancillary activity to that activity will follow the same business line treatment.
- Banks may use internal pricing methods to allocate gross income between business lines provided that the sum of gross income for the eight business lines must still be equal to the gross income as would be recorded if the bank uses the basic indicator approach (BIA).

¹ Ancillary function is an activity/function that is not the main activity of a given business line but only as a support activity.

- The process by which banks map their business activities into the standardized business lines must be regularly reviewed by party independent from that process.
7. In computing the gross income of the bank, the amounts of the income accounts reported in the operational risk template² must be equal to the year-end balance reported in the Financial Reporting Package (FRP). Any discrepancy must be properly accounted and supported by a reconciliation statement.

Application Process for the Use of TSA

8. Banks applying for the use of TSA should submit the following documents to their respective central points of contact (CPC) in the BSP:
- An application letter signed by the President/CEO (or equivalent management committee in the case of foreign bank branches) of the bank signifying its intention to use TSA in computing the capital charge for operational risk;
 - Written documentation of the Board-approved operational risk management framework as described in paragraph 3.
 - Written policies and criteria for mapping business activities and their corresponding gross income into the standard business lines as described in paragraphs 5 to 7.
 - An overall rollout plan of the bank including project plans and execution processes, with the appropriate time lines.

Initial Monitoring Period

9. The BSP may require a 6-month period of initial monitoring of a bank's TSA before it is used for supervisory capital purposes.

Reversion from TSA to BIA

10. A bank which has been approved to use TSA in computing its capital charge for operational risk will not be allowed to revert to the simpler approach, i.e., the BIA. However, if the BSP determines that the bank no longer meets the qualifying criteria for TSA, it may require the bank to revert to BIA. The bank shall be required to repeat the whole application process should it opt to return to the use of TSA, but only after a year of using the BIA.

² Part V of the revised Capital Adequacy Ratio (CAR) report template

The issuance of the subject guidelines to the banking community forms part of the BSP's commitment of providing continuous assistance to banks' preparatory work for the eventual implementation of the revised risk-based capital adequacy framework in the Philippine banking system.

This Memorandum shall take effect fifteen (15) calendar days after its publication either in the Official Gazette or in a newspaper of general circulation.



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Officer-In-Charge

21 June 2007