RESERVE BANK OF NEW ZEALAND
TE PŪTEA MATUA

BPR150

Standardised Operational Risk

Purpose of document

This document sets out the standardised methodology for calculating a bank's operational risk capital requirement. This is part of the calculation of capital ratios, as defined in BPR100, which a bank must carry out to determine its compliance with minimum regulatory capital requirements. This document applies to any bank that is subject to minimum capital requirements and has not been accredited by the Reserve Bank to use the Advanced Measurement Approach (AMA) for operational risk.

Document version history

[1 July 2021]	First issue date

Conditions of registration

The Reserve Bank of New Zealand Act 1989 (the **Act**) permits the Reserve Bank to impose conditions of registration (**conditions**) on registered banks[1].

This document BPR150: Standardised Operational Risk forms part of the requirements for the following conditions:*

- A New Zealand-incorporated registered bank is normally subject to a condition requiring it to maintain capital ratios above specified minimum levels, and also to a condition imposing restrictions on its dividend payments when its prudential capital buffer ratio falls below specified levels.[2] This document sets out the operational risk capital methodology that will be needed by such a bank (unless it is accredited to use the Advanced Measurement Approach for operational risk), to allow it to calculate its day-to-day values for the capital ratios and the capital buffer ratio, and hence monitor its compliance with these capital adequacy conditions.

> ** All of the material set out in this document forms part of the requirements of the applicable condition, except material that is expressly identified as guidance by being included in a shaded box like this.*

1 The conditions can relate to any of the matters referred to in sections 73 – 73B, 78 and 81. The standard conditions are contained in Appendix 1 of document BS1: Statement of Principles.

2 These conditions of registration relate to the matter referred to in: section 78(1)(c) (capital in relation to the size and nature of the business).

BPR150: STANDARDISED OPERATIONAL RISK

Part A: Introduction

Part B: Calculation of capital requirement

Contents

Part A: Introduction

A1 Overview and definitions

A1.1 Overview

This document sets out the methodology a bank must use to determine its capital requirements for operational risk when it is required to use the standardised approach.

Guidance: A bank's operational risk capital requirement forms part of the calculation of its capital ratios, as specified in subpart B2 of BPR100: Capital Adequacy.

Source: BS2A, para 118.

A1.2 Definitions

(1) In this document, unless the context otherwise requires,—

all other activities means any activity that is not retail and commercial banking

corporate finance activities—

(a) include those activities that are undertaken primarily to generate non-interest fee-based income; but

(b) exclude fee-based income derived from the provision of transaction services related to lending activity and deposit taking

Guidance: Corporate finance activities include, for example, underwriting, and the provision of advisory services related to mergers and acquisitions or privatisations.

retail and commercial banking–

(a) means all banking book activities; and

(b) includes–

(i) lending to households, non-profit organisations, small and medium enterprises (**SME**s), sovereigns, multilateral development banks and other international organisations, public sector entities, banks, and corporate customers; and

(ii) provision of transaction services related to lending activity and deposit taking

(2) Accounting terms used in this document must be determined in accordance with GAAP.

*Guidance: **Operational risk** has the meaning given in the Glossary.*

Source: BS2A, para 119, 120(2).

Part B: Calculation of capital requirement

B1 Capital calculation

B1.1 Division of activities

For the purposes of calculating the standardised capital requirement for operational risk, a bank must divide its activities into two categories:

(a) retail and commercial banking; and

(b) all other activities.

Guidance: The standardised operational risk capital requirement is the sum of two components, covering the operational risk arising on retail and commercial banking business on the one hand (subsection (a)), and all other activities on the other (subsection (b)).

Source: BS2A, para 120(1).

B1.2 Operational risk capital requirement for retail and commercial banking

(1) A bank must calculate its operational risk capital requirement for its retail and commercial banking area of business by–

(a) taking the last twelve consecutive quarterly observations of **gross retail and commercial loans and advances**; and

(b) multiplying gross retail and commercial loans and advances at each observation point by 0.525%; and

(c) summing the 12 quarterly results produced in paragraph (b) and dividing the resulting sum by 12.

(2) For the purposes of calculating its gross retail and commercial loans and advances under subsection (1)(b), the bank must use the sum of the following amounts before deducting allowances for impairment:

(a) loans and advances to retail customers, including purchased retail receivables; and

(b) loans and advances to SMEs, including purchased receivables; and

(c) loans and advances to corporates, sovereigns, multilateral development banks and other international organisations, public sector entities, and banks, including purchased receivables but excluding funded positions arising from corporate finance-related activities; and

(d) securities held in the banking book, excluding those that are deducted from capital.

Source: BS2A, para 121, para 123(1).

B1.3 Operational risk capital requirement for all other activities

(1) A bank must calculate its operational risk capital requirement for its all other activities area of business by–

(a) taking the greater of zero and **adjusted gross income from other activities** earned over the quarter for each of the last 12 quarters; and

(b) multiplying the amount derived at each observation point by 18%; and

(c) summing the 12 quarterly results determined in paragraph (b) and dividing the resulting sum by 3.

(2) For the purpose of subsection (1), the bank must calculate adjusted gross income from all other activities as total profit or loss before taxation, less the following amounts:

(a) net interest income from retail and commercial loans and advances; and

(b) net fees from the retail and commercial banking area of business, including–

(i) net fees from retail and commercial loans and advances; and

Guidance: These fees include, for example, loan establishment fees, administration fees, and penalty fees.

(ii) net fees from retail and commercial transaction accounts; and

(iii) net fees from automatic teller machine networks; and

(c) net impairment losses on assets; and

Guidance: These assets include, for example, financial assets, intangibles, and physical assets.

(d) realised profits or losses from the sale of banking book items; and

(e) income derived from insurance activities; and

(f) total other operating expenses; and

Guidance: These expenses include, for example, fees paid by the bank to outsourcing providers.

(g) income and expenses from irregular items.

(3) To avoid doubt, the net income that a bank obtains from its involvement in securitisation (including servicing), trading, and corporate finance activities must be included in adjusted gross income from other activities.

Guidance: For trading activities, net income includes profits and losses on instruments held for trading.

Source: BS2A, para 122 and 123(2).

B1.4 Total operational risk capital requirement

(1) The total capital requirement for operational risk is the sum of—

(a) the operational risk capital requirement for its retail and commercial banking business calculated in accordance with section B1.2; and

(b) the operational risk capital requirement for its all other activities area of business calculated in accordance with section B1.3.

(2) The bank must use the following formula for calculating its total operational risk capital requirement:

$$K_{SA} = \frac{\sum_{t=1}^{12}(0.00525 \times LA_t)}{12} + \frac{\sum_{t=1}^{12}\max\left[(0.18 \times AGI_t), 0\right]}{3}$$

where—

K_{SA} is the total standardised capital requirement for operational risk

LA_t is the dollar value of gross retail and commercial loans and advances measured at the end of financial quarter "t"

AGI_t is the dollar value of adjusted gross income from other activities earned over financial quarter "t"

t is an index of consecutive quarterly observations running from 1 to 12, where t=12 represents the most recent period for which observations are available.

(3) However, if actual observations are not available, the Reserve Bank will specify an alternative means of determining capital requirements for operational risk, appropriate to the particular circumstances involved.

Guidance: An example of a situation in which actual observations will not be available is when a bank is in its first years of operation.

Source: BS2A, paras 123(3) to (6).