

23 June 2010

Feedback statement on the consultation paper on the management of operational risks in market-related activities (CP 35)

1. On 21 December 2009, CEBS submitted the “draft Guidelines on the management of operational risk in market-related activities” for public consultation - the consultation period ended on 31 March 2010. Thirteen responses were received; only one respondent did not wish its comments to be published¹.
2. In addition to soliciting written comments, CEBS provided an opportunity for industry to provide further input at a public hearing with CEBS experts on operational risk, arranged on 09 March 2010. More than 30 participants from institutions, and industry associations including consultants and journalists took part in the hearing, whose summary and outcome were published on 16 March 2010².
3. Most respondents supported the Guidelines objective to achieve greater convergence of supervisory practices and enhance the operational risk management in market-related activities by strengthening the governance mechanisms, internal controls and reporting systems of institutions. While most of the respondents agreed with the seventeen principles set in the Guidelines, some of them were of the opinion that the criteria and examples describing those principles were too prescriptive and too detailed.
4. Respondents also provided suggestions for further improvements and adjustments to the proposal, in particular regarding the detection and prevention of fraudulent behaviour (Principle 5); the audit trail requirements (Principle 9); the confirmation, settlement and reconciliation processes of the executed transactions (Principle 11); the monitoring of nominal values of the transactions (Principle 14) and, more in general, the interfaces between operational risk and market risk management. The latter is, to a large extent, already covered by the

¹ The public responses to CP35 are published on the CEBS website under the following link: <http://www.c-ebs.org/Publications/Consultation-Papers/All-consultations/CP31-CP40/CP35/Responses-to-CP35.aspx>

² The summary is published on the CEBS website under the following link: <http://www.c-ebs.org/documents/Publications/Consultation-papers/2009/CP35/SummaryofPHonCP35.aspx>

Guidelines dealing with the scope of operational risk and operational risk loss, published as part of the “Compendium” on 8 September 2009.

5. The consultation paper has been revised on the basis of the comments received, and as a result of input at the public hearing. The revised consultation paper has adopted a significant number of suggestions put forward for the topics under consultation. However, in consideration of the substantial feedback provided by the respondents, CEBS decided on a second consultation period of one month in line with its consultation practices.³ The second round of consultation aims to receive feedback on the main aspects of the consultative document, which had been amended by CEBS in response to industry requests, but will not entertain topics which were not commented on in the previous round or are considered to be of minor importance.
6. In the Annex, a feedback table is provided which gives a detailed description of the comments received and CEBS’s responses to them.

³ The consultation practices are published under the following link: http://www.c-ebs.org/getdoc/eed60d2e-5caf-494f-9422-2467ba1e4bbb/20080805_CP01rev.aspx

Feedback table on CP35: analysis of the public responses and suggested amendments

The first column of the feedback table makes reference to the terminology and paragraph numbering used in the original CP35. The last column refers to the terminology and paragraph numbering as in the final guidelines; where the paragraphs have been re-numbered or newly numbered, this has been made clear.

| CP35 | Summary of comments received | CEBS's response | Amendments to the proposals set out in CP35 |
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| Guidelines on operational risk management in market-related activities | | | |
| 1. Introduction | | | |
| General Comment | Two respondents required a further consultation period. | The published CEBS consultation procedures include the possibility of a second consultation period. The comments have, to a large extent, been accommodated. As some substantial issues have been raised, CEBS will grant a second consultation period of one month. | Comment accommodated |
| General comment | Respondents asked that it be stated in the guidelines that national requirements also have to be fulfilled. Those may not be consistent with the proposed CEBS guidelines. | The establishment of a harmonised regulatory framework is one of the objectives of the guidelines. The guidelines need to be implemented by the supervisory authorities in a "comply | No change |

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| | | or explain" approach, taking also into account the national specifics. This ensures that the applicable regulatory framework is consistent with the national legislative framework. | |
| General comment | Some respondents perceived the level of detail as being too high, so that the guidelines were regarded as too prescriptive. The guidelines should be reviewed with the aim of better differentiating between principles and examples. | The guidelines were reviewed considering the more detailed comments. | See comments regarding the single paragraphs |
| General comment | Respondents asked that the guidelines be restricted to operational risk management as the tasks contained in the principles and explanations are sometimes also directed to the management of market risk. | Some boundary issues may also exist regarding the processes or systems in market-related activities which are used to manage market risk positions in a way that also prevents operational risks from occurring. As a result, a distinct separation of risk management tasks among different risk types is not possible. However, the guidelines on the Scope of Operational Risk and Operational Risk Loss (CEBS paper published in September 2009, labelled as the "Compendium"), which provide detailed guidance on the boundaries between operational risk and market risk, may help in clarifying the object of operational risk in market-related activities, hence to better position the scope of this document | New Para 7 and 9 added and renumbered Para 8 amended |
| General comment | Respondents asked for clarification as to whether the guidelines apply only to larger banks and whether smaller institutions need to implement all | The guidelines are applied in the spirit of the principle of proportionality. Smaller and less complex institutions | Footnote added to renumbered Para 10 (old |

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| | measures contained in the document. | may have more leeway in implementing the guidelines in a less sophisticated way. | Para 8) |
| General comment | <p>"In order for these guidelines to be effective in global institutions they will need to be deployed across all regions; this will require the engagement of supervisors, both home and host, outside of the EU. We would welcome clarification on the extent to which this has been undertaken and the response received"</p> | <p>It is in the interest of the institutions themselves to implement sound governance arrangements. CEBS, as well as other regulatory bodies, is working on enhancements of corporate governance standards. As a result of the consultation, CEBS is confident that the guidelines reflect sound practices regarding this matter and accordingly do not create an undue implementation burden.</p> <p>The Basel Committee's Standard Implementation Group on Operational Risk (SIGOR), -which shares quite a few members with the respective CEBS working group – was furnished with CP35. The document spells out supervisory expectations regarding the matter of corporate governance in the field of market related activities. However, CEBS guidelines are neither directives nor regulations; they are implemented by national supervisory authorities. The issue of whether the corporate governance arrangements are sufficient or not will be assessed in the Supervisory Review Process. Results of this will be discussed in colleges; those also include non-EU</p> | No change |

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| | | authorities. | |
| General comment | It was suggested that the paper be structured along the concept of the three lines of defence, to stress the role of risk control and to elaborate more on the new product approval process. | The guidelines focus on operational risk management in market-related activities. Broader guidelines on internal governance, including the new product approval process are contained in the CEBS guidelines on Supervisory Review Process and also in the High Level Principles on Risk Management. CEBS plans to publish a consultation paper containing a comprehensive guidebook on internal governance around yearend. | No change |
| General comment | Respondents commented that a clarification of market-related activities – possibly in connection with specific products or transactions – would be helpful for the practical implementation of the principles. | Given the dynamic development of products, the creation of an exhaustive list is not possible. In addition, the type of market-related activities also differs from institution to institution with regard to size and complexity. Accordingly, CEBS deliberately did not include such definitions. | No change |
| General comment | Respondents asked that the legal basis and the matter of the relevant competent authority be clarified. | In respect of market-related activities, not only is Article 22 of the CRD applicable, but also the MiFID and other directives. While EU regulations are directly applicable, directives need to be implemented by the member states. The level 3 guidelines as provided, do not constitute either a directive or a direct applicable regulation, rather, they will be implemented and applied by the supervisory authorities in line | No change |

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| | | with other regulatory requirements. As a result, with regard to some specific issues (e.g. the recording of phone calls) institutions also have to comply with host legislation which can be stricter than the home regulation. | |
| 1 | Respondents asked CEBS to specify that the wording "every credit institution" clearly applies to all types of financial institutions including investment banks | Paragraph 1 quotes Article 22 of the directive 2006/48/EC, the guidelines apply to all institutions to which this article applies, this includes credit institutions and investment firms (see also directive 2006/49/EEC) | No change. |
| 2 | Respondents said that "human error should be included in operational risk events" | This is already included in the definition of operational risk (Article 4 dir 2006/48/EC). However a reference to "people" as drivers of operational risk was included in new Para 7. | New Para 7 added and document renumbered |
| 2 | Comments were made to the effect that the statement that banks have "overlooked the importance of operational risk" does not take into account what actually happened in practice. | In the past, some major operational risk events in market-related activities occurred. The analysis of those showed that the level of operational risk management in those areas was not sufficient. This might not have been the case for all institutions. However some institutions clearly have not fully recognised the importance of operational risks. | Para 2 amended |
| 3 | It was suggested that the governance and operational risk events specifically mentioned should be elaborated on in more detail. | The guidelines aim to provide general principles on appropriate operational risk management in market-related areas. Even if detailed examples were | Para 3 amended |

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| | | to help illustrate the guidelines, CEBS - having regard to confidentiality issues as well - does not intend to provide a detailed loss event analysis. The example was deleted. | |
| 9 | Respondents commented that the implementation of the guidelines would take longer than yearend 2010 and asked for clarification on the implementation date. | The implementation date is a mandatory date for the implementation of the guidelines in the national regulatory framework by the supervisory authorities and is not directly applicable to the institutions this is already stated in the guidelines. After their implementation, the guidelines will be applied by the supervisory authorities - this usually includes a sufficient time frame for implementation. The implementation date will be changed according to the publication of the final guidelines. | Para 11 amended |
| 10 | The paragraph is not needed after the consultation period ended. | The description of the consultation procedure has been deleted. | Para 10 deleted and document renumbered |
| 2. Governance mechanisms | | | |
| Principle 1 | Respondents suggested replacing "full awareness" of the management body by "appropriate" or "adequate awareness". | This paragraph deals with risk awareness, which differs from the knowledge of specific risk profiles. In the past not all institutions have been sufficiently aware of operational risks in market-related activities. "Full" was deleted, as the management body will | Principle 1 amended |

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| | | usually focus on material risks. | |
| 11 | Respondents commented that the risk management representative within committees should have sufficient product knowledge and the power to reverse trades. | The “knowledge issue” is dealt with in Principle 3 and in the High Level Principles on Risk Management. The latter also contains guidelines regarding the power of the risk management function. The CRO should have a strong position within the institution and responsible risk committees. However, the power to reverse trades is not explicitly required. | No change |
| 12 | “Guarantee” should be replaced with “provide for” as it is not possible to guarantee the segregation of duty with certainty | The comment was accommodated. | Renumbered Para 13 amended |
| 13 | As long as there is a strong functional management, the organisation of control functions along the different business units may be beneficial and increases the understanding of the business. | The guidelines aimed at clarifying which kind of fragmentation is problematic. | Renumbered Para 14 amended |
| 13 | It was suggested that sub-bullets be removed as they are unduly prescriptive. | The proposed bullets should be taken into account by institutions, but there is no prescriptive rule regarding the organisational aspects. The language was clarified. | Renumbered Para 14 amended |
| 13 | To focus more on the control function, the following wording was suggested: The fragmentation between.... To this end: <ul style="list-style-type: none"> • Clear process owners should be identified | Some weaknesses identified in previous rogue trading events, resulted from the fragmentation of control functions. Some institutions see benefits in organising the control units alongside the business. In those cases, | Renumbered Para 14 amended |

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| | <p>for each key process</p> <ul style="list-style-type: none"> • A clear statement of the responsibilities and scope for each control unit should be established, in order to avoid gaps and overlaps in the control framework and guarantee accountability for each control unit on its perimeter. • The organization should encourage and promote the capability of the institutions to have an overview of the results of controls produced by control units. Banks should define and document the extent to which they wish to strike a balance between operational proximity and control centralization, given the types of controls and the organization in place, | <p>institutions need to ensure that no gaps in the control framework exist.</p> <p>See also comments above.</p> | |
| Principle 2, 14 | Code of conduct should be replaced with “having appropriate policies setting standards” as firms may not have implemented those in one single code of conduct | The comment was accommodated. | Renumbered Para 15 amended |
| 14-15 | It was suggested that on this point the wording be more specific e.g. to include the possibility of escalation which can be used to remedy adverse developments. | The risk culture should be implemented in a way that supports professional and responsible behaviour. This includes the implementation of the code of conduct enforced by the management body within the different parts of the institution, appropriate training procedures and appropriate ways for all employees to communicate confidentially any material violation of the desired risk culture directly or | Renumbered Para 15 amended |

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| | | indirectly to the management body. | |
| 14-15 | A sound risk culture should not be limited to the front office. The following paragraphs should be structurally neutral, to avoid synergies falling away. There should be no attempt to force firms towards particular business models and management structures. | <p>The guidelines stress the importance of a sound risk culture in the front office; of course, this applies to the whole institution and with regard to all risk types as well. These points are already included in the High Level Principles on Risk Management.</p> <p>The formulated measures are broadly considered to be best practices, CEBS does not see how these would force firms to adopt particular business models and management structures.</p> <p>However, the language was clarified.</p> | Principle 2 and Para 15 amended |
| 15 | <p>It was suggested that the guidelines be amended regarding "two consecutive weeks leave" as this might not be in line with national laws.</p> <p>Also the following wording was suggested: Appropriate policies...should be developed, implemented and regularly monitored according to local labour regulations.</p> | As the guidelines will be implemented by national authorities on a comply or explain basis, this should not contradict national laws. However, the issue of two weeks leave can also be accomplished by a "desk holiday" preventing the employee from having access to front office IT systems. The wording was amended to clarify the issue. | Renumbered Para 16 amended |
| 15 | It was suggested that the importance of fraud detection be stressed. The introduction of a back testing requirement for reported incidents and outstanding risk events was suggested. | Fraud detection is included in Principle 5, a lessons-learned process was added to the examples mentioned. | Para 24 amended |

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| 15 | <p>"Although staff movements between front, middle and back-office may entail a certain risk potential, especially within a trading product category, we consider that labour law aspects already render the requirement of "close monitoring" problematic. We request the deletion of the word "close". Furthermore, the paper gives no indication of how such monitoring should be organised. Examples would be helpful here."</p> | The wording was clarified; the guidelines apply to the change of positions. | Renumbered Para 16 amended |
| Principle 3, 16-19 | <p>Respondents asked for more specific criteria to allow assessment of control functions personnel.</p> | The level of knowledge depends on the business conducted by the institution and the complexity of products. This also includes knowledge of the techniques used to value products and assess risk. | Para 17 and 18 amended |
| 18 | <p>The systemic analysis of suspense accounts is not explicitly mentioned, even though the analysis of the nature of the positions in the suspense accounts and the detection of undesired developments are important processes. The signalling function of reports is also not mentioned.</p> | The need to analyse these accounts was added to the text. Regarding reporting, CEBS felt that the guidelines were sufficient, as they state "Any suspicious activity across these accounts should be escalated to, and acted on, by senior management." The paragraph was moved to Principle 13. | Para 55 amended |
| Principle 4, 21 | <p>Respondents suggested a direct reference to limits and that what constitutes "a maximum acceptable level of operational risk" be clarified.</p> <p>It was suggested that the setting of limits be reduced to internal events, as external events drive the capital, but are not under direct control of the business unit.</p> | <p>A non-exhaustive list of possible approaches has been added to the renumbered Para 22. The setting of limits should be in line with the risk appetite and the risk strategy defined by the institution.</p> <p>As the occurrence of events cannot be</p> | Para 21 amended |

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| | <p>Respondents commented that limits may also be set in a qualitative way.</p> <p>Effects on remuneration could hinder the reporting of operational risks.</p> | <p>totally ruled out, even if to date, no such event has occurred, the calculation of the exposure needs to be based on external data as well. A limitation to internal data might not be reasonable, as due to the scrutiny of data, a risk measure cannot be calculated on this basis.</p> <p>Institutions should be able to consider the last point in their practices or to counterbalance such effects via appropriate controls.</p> | |
| 21 | <p>It was suggested that operational risk losses be deleted, as those can vary over time.</p> | <p>More examples of how objectives could be set were added (see comment above). Institutions may also choose only a subgroup of operational risk losses or specific aspects of their distribution, as a result, operational risk losses was kept as one possible example.</p> | No change |
| 21 | <p>Consistency of the text regarding local requirements.</p> | <p>The sentence "However, this should not violate regulations on the protection of personal data and other relevant legislation." was deleted. The establishment of a harmonised regulatory framework is one of the objectives of the guidelines. The guidelines need to be implemented by the supervisory authorities in a "comply or explain" approach, taking into account also the national specifics. This ensures that the applicable regulatory</p> | Para amended 21 |

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| | | framework is consistent with the national legislative framework. | |
| Principle 5 | It was suggested that “key” instead of “pivotal” element be used. | The comment was accommodated | Principle 5 amended |
| 22-23 | It was suggested that both paragraphs be deleted. | The statement in Para 22 is already underlined in Para 2 and 3. Accordingly, Para 22 was deleted, a new Para (23) was added and the old Para 23 was merged with Para 24 (see comment below) | Old Para 22 deleted. New Para 22 added; old Para 23 merged with old Para 24 |
| 23 | It was requested that specific information on scenarios to be used be furnished and the usefulness of scenarios for these purposes was also questioned. | Scenarios have to be developed by the institutions, taking into account the necessary business activities, processes and systems. CEBS believes that scenario analysis, as well as other known techniques in the operational risk field, is useful in assessing not only the probability, but also the impact of fraud events. | No change |
| 23 | It was suggested that paragraphs 23 and 24 be merged as scenarios are only one possible way of understanding how fraud may occur. The BIA or TSA institution, in particular, may not implement all measures mentioned in the examples. | The comment was accommodated. The principle of proportionality provides sufficient flexibility for the implementation in BIA or TSA institutions. However, it was not intended to provide an exhaustive and binding list of examples. | Para 23 merged with Para 22 and amended |
| 24 | Respondents asked to provide examples for fraud prevention measures, especially regarding fraud testing and indicate an appropriate frequency for such tests. In addition, a direct reference to the | Fraud prevention measures need to be defined by the institutions, depending on their business model, taking into account their specific fraud exposure. | Para 23 amended |

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| | actual processes should be made. Information security may also be an issue. | Regarding fraud testing, a few examples have been added. Institutions should bear in mind that the definition of fraud also contains internal limit breaches and differs from the fraud definition of criminal laws. Depending on the anti-fraud measure, the frequencies may differ significantly, while some are aiming at the daily market risk related processes, others may be performed less frequently, but in any case, on a regular basis. | |
| 24 | It was suggested that a lessons learnt process be included in the examples. | The suggestion of a lessons learnt process was integrated into the document. | Para 23 amended |
| 24 | It was suggested that the paragraph be reworded: "...allowing management to identify and respond to any fraudulent activity in a timely manner" | The comment was accommodated | Para 23 amended |
| 24 | It was suggested that "regular fraud testing" be replaced by "regular fraud scenario analysis". Actual fraud testing, i.e. the creation of fictitious deals in systems for instance, cannot be carried out on a regular basis, since they could generate significant operational risks. External fraud scenario analysis and back testing, however, are necessary. | The paragraph was amended to clarify what the supervisory expectations regarding fraud testing are. It is not intended to ask institutions to carry out the described kinds of "fictitious deal" test regularly. See also comments above. | Para 23 amended |
| 25 | The following wording was suggested: "A duty to notify the appropriate level of management should be instituted for incidents exceeding pre-determined risk tolerance levels, with appropriate | The comment was accommodated; the language clarified. | Para 24 amended |

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| | escalation process." | | |
| 26 | It was suggested that "in accordance with local requirements" be added to the guideline regarding the notification of supervisory authorities | Supervisors need to be informed of significant losses, including those related to fraudulent events. Supervisors will have to implement this requirement and the others of the document - according to a "comply or explain" approach – in the way deemed most appropriate within their jurisdiction (see also comment above). | No change |
| 3. Internal controls | | | |
| Principle 6, 27 | Verifications should rather be on the nature and volume of the financial instruments used, than on their nature and number. | The comment was accommodated | Para amended 26 |
| 27 | Some wording changes were suggested. | The comments were broadly accommodated; "precise" was changed to "appropriate" and "circumscribing" to "describing". The description should be applicable to the "activity of each trader" and cannot be limited to a business division, as the authorities for traders usually differ. However, there may be parts of such descriptions which may be applicable to a group of traders, while others need to be spelled out by each trader. | Para amended 26 |
| 28 | The following wording was suggested, "One objective of an authorised trading framework for the front office should be to formalise rules for trading desks enabling them to ensure they | The wording suggestions were broadly accommodated. | Para amended 27 |

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| | operate within a clear framework. Examples of deliverables could include lists of permitted products, market-risk limits and supervisory guidelines for desk heads. The rules should be updated on an on-going basis. An appropriate process of escalation and challenge should be in place to investigate any breach of permitted activities or limit breaches." | | |
| 30 | It should be clarified that "immediately" only applies to the transmission of data | The wording was clarified. | Para amended 29 |
| 31 | <p>Respondents suggested skipping the taping requirement as the MiFID is under review regarding this matter and the requirement might contradict national data protection laws.</p> <p>The term "taping" should be replaced with "recording"</p> | Taping is a usual control measure so far as it is legal in the given jurisdiction. The establishment of a harmonised regulatory framework is one of the objectives of the guidelines. The guidelines need to be implemented by the supervisory authorities in a "comply or explain" approach, taking into account also the national specifics. This ensures that the applicable regulatory framework is consistent with the national legislative framework. | Para amended 30 |
| Principle 7 | It was recommended that the sentence "Legal enforceability of the contracts should be assured" be removed. It is sometimes not possible to achieve such a level of comfort. | The language was clarified | Principle amended 7 |
| 32-33 | It was requested that documentation requirements be delineated more clearly and that references also be mentioned, for example, to IFRS, SOX and MiFID. | All documentation requirements included in applicable regulations have to be fulfilled. CEBS does not intend to create a repository of all applicable requirements. Institutions have to | No change |

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| | | ensure that they have appropriate documentation in place. | |
| 32 | It was recommended that the statement be amended to read "arrangements should be agreed upon and documented in advance of trading where feasible". | The comment was accommodated | Para amended 31 |
| 33 | Respondents commented that "closeout" netting is not authorised in all jurisdictions. | The comment was accommodated. | Para amended 32 |
| 34 | It was recommended that the statement be amended to read "These trades should be identified as soon as possible by for review by the relevant control functions". | The comment was accommodated. | Para amended 33 |
| Principle 9 | It was noted that it is important to have an audit trail process; the follow up to the cash flows is possible without having a readily available "push button" audit trail. It was suggested that "audit" be deleted from Principle 9. | A "push button" audit trail may be quite convenient. However, the objective of Principle 9 could be achieved differently; the principle does not contain the aforementioned requirement. The reference to "audit" was kept, as this is a commonly used reference for this process. | No change |
| 36-37 | Respondents commented that a front-to-end audit trail is not in place in all institutions as it is very burdensome to implement (Principle 9) and asked for clarification of the term "documented audit trail" Transactions are mapped to books or portfolios and not to a single trader. | The principle of proportionality is applicable; the wording was clarified. However, to analyse fraudulent activities, banks should be able to track transactions back to the appropriate level of granularity (e.g. trader, book, product, etc.). | Para 35 and 36 amended. New Para 37 added |

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| 36-37 | Principle 9 focuses on cash-flows; sometimes, the cash flow of a transaction is delayed. These transactions need to be considered as well. | The formulated principle applies for all transactions, even if the cash flow is delayed. | Principle 9, Para 35 and 36 amended |
| 36-37 | <p>The following wording was suggested:</p> <p>"36. The audit trail should make it possible to trace cash flows both downstream and upstream – from the trader to the external counterpart — at least on demand. The accounting for the cash flows requires very strict monitoring and control.</p> <p>37. Extended audit trails, to identify transactions from the point of origin by each trader, is necessary and must be demonstrated on demand when needed, for the institutions' systematic ex post control and reconciliation, both by internal controllers and external auditors, of the operations carried out."</p> | The suggestions and other comments received on the subject were broadly accommodated. | Para 35-36 amended |
| 30 and 37 | It was suggested that the paragraphs be merged. | The paragraphs concern different principles and cannot be merged. | no change |
| Principle 10 | It was suggested that the principle should read: "Institutions should ensure that they have an appropriate framework of internal control around the relationships between traders and their market counterparts". | The principle covers not only the internal control function, but also activities of the business area. The suggested wording might be understood to limit the responsibility to the independent internal control function. The comment was accommodated and the wording clarified. | Principle 10 amended |
| 39 | Institutions asked to provide more information | Appropriate controls may also include a | Para 39 |

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| | regarding control mechanisms on the pricing of operations. | review of the pricing. Pricing failures will lead to losses or may even lead to gains. A review of remarkable losses and gains could help identify pricing issues. However, pricing could be controlled by other measures as well. The pricing issues aspect was included in renumbered Para 40 | amended |
| 39 | <p>Respondents commented that a “review of the relationship between market counterparts and front office staff” is not practical.</p> <p>The paragraph should be clarified.</p> | Even if a review of the relationship may not be easy to achieve, the relationship of front office staff to counterparties may affect the management of operational risk events as well as the operational risk profile. Given this, institutions should consider these relationships and try to monitor them as well as the treatment of operational risk events. | Para amended 39 |
| 39 | <p>Directing commercial issues to a control function is not realistic. In practice, these functions are often dealt with by the business, but outside the trading function.</p> <p>It was recommended that the MIFID or MAD terms “professional clients and eligible counterparties” be used instead of “market counterparties”</p> | The comment was accommodated, the paragraph was reformulated to better distinguish between the responsibilities of the business and the control functions. The involvement of the control functions is considered crucial to providing an independent review of the issues. | Para amended 39 |
| Principle 11, 40 | <p>Respondents commented that the resolution of confirmation issues is only possible with involvement of the business unit.</p> <p>It was suggested that the wording “without</p> | The guidelines focussed on the process. It was clarified that control functions should remain accountable for the confirmation, settlement and reconciliation processes and that these | Para amended and new Para 41 added 40 |

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| | involving the front office" be deleted | functions may require the involvement of the business in carrying out their tasks. | |
| 40 | Respondents asked for clarification of the terms "gaps and points of weakness" | Institutions should regularly assess the appropriateness of their confirmation, settlement and reconciliation processes in order to identify potential gaps in the process and significant points of weakness. The processes should be regularly assessed | Para 40 amended |
| 42 | <p>The following wording was suggested: "Pending the completion of full documentation and confirmation processes, consideration could also be given to the use of affirmation processes. Affirmation process is intended to demonstrate the existence of the transaction, in order to mitigate fraud risks".</p> <p>Others commented that the wording of the paragraph is not clear.</p> | The comment was accommodated, the paragraph redrafted. | Renumbered Para 43 amended |
| 41 | "The reliable process for confirmation required in the first sentence of paragraph 41 should be supplemented to the effect that in the case of trades which are cleared via a settlement system ensuring an automatic reconciliation of the closing dates (confirmation matching systems); the confirmation process can be waived. The same should apply in cases where the settlement system of the two parties to the transaction allows consultation as to the closing dates at any time. A separate confirmation or acknowledgement could only lead to further | The text was amended to accommodate the comments and the wording clarified. | Renumbered Para 42 amended |

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| | transfer errors (e.g. operational risks)." | | |
| 44 | Respondents asked that "by a business unit independent of both functions" be deleted as it is not clear how a unit independent of both the front and back offices would report in an organisation. | The comment was accommodated | Renumbered Para 45 amended |
| 44 | Respondents commented that the last sentence should be deleted as it is too prescriptive. | The use of key risk indicators is one possibility way of detecting fraud risks. This aspect was deleted from this paragraph and added to paragraph 24. | Para 23 and renumbered Para 45 amended |
| 41-44 | Participants commented that the confirmation issues (paragraphs 43 and 44) need to be clarified. Not all positions are confirmed on a daily basis. The market standards must be recognised. Internal transactions are often controlled by different processes. Exceptions to the general criteria should be allowed in specific situations. Un-affirmed and un-confirmed transactions should be reported appropriately. | The text was amended to accommodate the comments and the wording clarified. | Para 41-44 amended |
| 45-46-47, | <p>Respondents asked for clarification. Are supervisors looking at confirmation or affirmation of processes? Do the recommendations address Nostro or treasury management?</p> <p>Respondents commented that it is also unclear whether this principle relates only to the requirement to have appropriate controls over Nostro balances and if this is the case it was suggested that references to the requirement to follow up on breaks and aged balances on a timely basis should be added. Respondents seeked confirmation that this point is not</p> | <p>CEBS has published separate guidelines on liquidity management, while this guideline focuses on operational risk management.</p> <p>The comments were taken into account. Paragraphs 45-46-47 were deleted and replaced with the suggested text.</p> | Old Para 45-47 deleted and renumbered Para 46 amended |

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| | <p>intended to cover liquidity management.</p> <p>The wording “real-time” should be avoided, as this is not possible.</p> <p>It was suggested that paragraphs 45-46-47 be deleted as they are not part of operational risk management and to replace them with the following sentence “Financial institutions should set-up cash reconciliation processes with an appropriate frequency sentence”</p> | | |
| 48 | A distinction should be made between inter-company and intra-company. For the latter, confirmations are often substituted by appropriate control processes. | The comments were accommodated and the wording clarified. | Para 47 amended and footnote added |
| 49 | It was noted that “Checking of novation agreements may appear very unlikely with certain type of customers located on the buy side or hedges funds” and that “The outsourcing should be more specifically detailed to be included in any control framework” | The guidelines refer to the control functions. Regarding outsourcing the specific CEBS guidelines apply. | No change |
| 49, 52 | Additional clarification was required on paragraph 49 which “sets out the various requirements for the settlement of OTC transactions. With a view to the regulatory initiatives to settle OTC derivatives in future via a central counterparty (CCP), we consider it necessary for the CCP also to satisfy the requirements of the confirmation, settlement and reconciliation processes. In cases | The guidelines do not distinguish between central counterparty settlements and others. For CCP settlements not all the suggested measures may be relevant or applicable. However, if there is no straight through processing into the institutions’ systems, there might be | Para 48 amended, Para 51 no change |

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| | where formerly OTC products were settled via a CCP, individual requirements of Principle 11 would not be applicable to the institutions. As we understand it, this would also be the case for certain requirements of Principle 12 (e.g. paragraph 52)." | the need for specific controls. | |
| 49-3 | The staffing levels should not be directed by the regulator. The text should be amended to "An appropriate function to verify...". And "professional associations" should be exchanged with "industry associations". | The text was amended. However, sufficient staffing is crucial in ensuring that the processes can be appropriately performed. | Para 48-3 amended. |
| 49-4 | "The use of secure commercial trading platforms capable of preserving a copy of each contract" should be replaced with "firms should retain documentation securely". A commercial trading platform is only one method of achieving the requirement. Such platforms are not in place for all products. | The comment was accommodated; the former text was kept as an example. | Para 48-4 amended. |
| 49-6 | "We believe that CEBS is referring to failed settlements rather than unsettled transactions as many transactions may not settle for a number of years." | The comment was accommodated. | Para 48-6 amended |
| 49-7 | "This should be deleted as outsourcing does not necessarily change the operational risk profile and indeed can offer an enhanced control environment if appropriately managed." | Institutions need to be aware of how outsourcing influences their operational risk profile. While outsourcing may reduce some risks, others might increase. Those risks need to be identified. | Para 48-7 and 48-8 amended and joined |

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| 49-8 | "This should be deleted as this should be true for all sections of the guidelines." | As this is quite important, especially considering the volatility of such products, we decided to keep the requirement to report any anomalies. | Para 48-7 and 48-8 amended and joined |
| Principle 12, 50 | Comments were made to the effect that margin and collateral calls cannot be traced to a trader, since they are common for some counterparts. However, when an anomaly is identified, financial institutions should be able to produce an audit trail and to trace the issue back to the transaction level and, therefore, to the trader level. | The language was clarified to accommodate the comment. | Para 49 amended |
| 50 | The attribution of collaterals and trades to traders or books should be limited to recently traded positions with material market risk, futures being the prime instrument. | When margins or collaterals are required, the amount may vary over time. As a result, appropriate controls need to be in place, and not just for recently traded positions. | No change |
| 53 | Respondents asked for clarification of the wording. Additionally, an analysis of the treasury position could be performed instead of an analysis of gross and net cash flows. The following wording was suggested: "Consideration should be given to the analysis of treasury position, on the one hand, and whether these can be understood in the context of the trader mandate, positions and reported P&L, on the other hand. Financial institutions should design and implement a workflow that could ensure appropriate investigation of disputes over collateral." | The language was clarified to accommodate the comment | Para 52 amended |

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| Principle 13, 54 | The point was made that a detailed breakdown of P&L is not always possible (e.g. correlation products) | The guidelines require that the aspects of P&L and its sources be understood. When analysing the P&L institutions may focus on large amounts, while it is not necessary to analyse smaller amounts. The requirement suggested by the comment is not included in this paragraph. The language was clarified. | Para amended 54 |
| 55 | "Consideration should be given to the challenges associated with monitoring off-market rates for some over the counter products" | CEBS is aware of such challenges. Off market rates might be identified in the P&L explain process (see also 54). | No change |
| 56 | Respondents suggested replacing "treasury activities" with "trading activities". The Para mixes several functions; those could be assigned to the more specific sections. | The language of the paragraph was clarified | Para amended 56 |
| 57 | It was suggested that the frequency of monitoring should be set according to the sensitivity of the activities, books, products or processes monitored. Financial institutions should be responsible for setting the appropriate monitoring frequency, with reference to the proportionality principle. Moreover, examples mentioned in proposition may not be relevant. For instance, provisions should be monitored on a daily, weekly or monthly basis, depending on their sensitivity. Also, it must be noted that for some types of controls, a too short periodicity may give rise to a situation where it becomes impossible to track relevant anomalies, and, therefore, inappropriate risk control. | The principle of proportionality applies to all the guidelines. The examples were deleted. | Para amended 57 |

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| 57 | There should be no granularity in the definition of the level and frequency of control. | The comment was accommodated. | Para 57 amended |
| Principle 14, 59 | Paragraph 59 asks that limits be set in terms of "Greeks", this is a typical part of market risk management. The guidelines should avoid dealing with controls that are not pertinent to operational risk management. | The new paragraph 8 addresses those issues in general. However, the comment was accommodated. | Para 59 amended |
| 59 | It was commented that fraud risk monitoring cannot be done on a real time basis and could, for several reasons, be done more efficiently in an overnight review process. Monitoring at a trader level is not possible either. | Institutions have to ensure that limits are complied with. This is not only an anti-fraud measure, but will also ensure that positions stay within the limits and accordingly comply with the strategy. As a result, limits should be updated in a timely manner. The reference to single traders was deleted. | Para 59 amended |
| 59 | Respondents asked for clarification as to whether the job of controller comprises the control functions referred to in paragraph 12. If so, then, the controller should also be mentioned in paragraph 12. | The monitoring of limits is usually performed by the control functions. | Para 59 and Para 13 amended |
| Principle 14 (Para 58-59) and 67 | Principle 14 aims to control positions at the level of each trader. This is not practical. Gross positions are booked and controlled on product or at portfolio level. | The paragraphs have been reviewed to accommodate the comment. However, as rogue trading is usually committed by a single trader, institutions should consider appropriate controls at trader level, taking into account the competencies, including the potential level of risk. | Principle 14 and Para 58, 59 and 67 amended |
| 58-59 | The terms "net amounts" and "gross notional | The wording was clarified by referring | Para 58 and 59 |

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| | amounts" should be clarified | to the nominal values (and cumulative nominal values) of the transactions. | amended |
| Principle 15 | It was suggested that the aspect of system maintenance be added to the guideline. | The comment was accommodated | Principle amended 15 |
| 62 | It was suggested that the wording be changed, as the old wording would require the use of biometric devices and this may not be possible in all jurisdictions: "the level of security of these systems should be regularly tested and monitored in order to prevent non-authorized access". | The comment was accommodated | Para amended 62 |
| 4. Internal reporting system | | | |
| Principle 16 | | Order of paragraphs changed | Order of par 63 and 64 changed |
| Principle 17, 65-69 | Respondents asked CEBS to suggest an appropriate level of granularity. | As stated in Para. 66, information needs differ among the recipients. This also depends on the complexity and size of the business. The reporting framework has to be defined by the institution. | No change |
| 66 | The point was made that reports aiming to detect operational risks in market-related activities should be produced under the aegis of the control functions, rather than by the control functions. Some reports cannot be directly produced by control functions. However, in these cases, control functions should design, specify and control the reports and should be held | In some cases, the business unit may provide the data needed for the report, or create the report. The comment was accommodated. | Para amended 66 |

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| | accountable for them. | | |
| 67 | <p>"A consolidated approach to risk management is imperative" should be replaced with "a comprehensive approach to risk management is recommended". The section from "For example ..." onwards should be deleted.</p> <p>Other respondents noted that a monitoring of performance indicators at trader level is not possible.</p> | <p>The idea of comprehensive/holistic risk management will be dealt with within the guidelines on internal governance, which are under review.</p> <p>The paragraph was limited to requirements regarding reporting. The example was deleted.</p> | Para 67 amended |
| 68 | Respondents commented that in addition to calls for corrective actions, reports should also contain a follow-up to the implementation of corrective actions. | Corrective actions should be tracked appropriately; this can be done in specific systems or separate reports. | Para 68 amended |
| 69 | Respondents suggested that documentation and implementation of an alert and escalation procedure could also be included in the scope of CP 35. | Reporting may differentiate between regular and ad hoc reporting, in addition, whistle blowing procedures may be implemented. These two points are already contained in the guidelines (Para 63). | No change |
| 68-69 | Paragraphs 68 and 69 should be deleted as they are simply observations. | Paragraph 68 provides simple, but relevant guidelines on reporting requirements. The internal audit function should review the reporting system. Paragraph 69 was redundant with the principle itself. | Para 68 and Para 69 amended and deleted. |