



Implementation Note

**Subject: Operational Risk Assessment Process for TSA & AMA
Institutions**

Category: Capital

No: A-1 Date: December 2005

I. Introduction

This document outlines the key principles and steps underlying OSFI's assessment of the Standardized Approach (TSA) and Advanced Measurement Approaches (AMA) to operational risk as outlined in Chapter 6 of the Draft Capital Adequacy Requirements (CAR) Guideline A and Chapter 7 of the Draft Capital Adequacy Requirements (CAR) Guideline A-1.

Banks and bank holding companies to which the *Bank Act* applies and federally regulated trust or loan companies to which the *Trust and Loan Companies Act* applies are collectively referred to as "institutions".

Institutions implementing the Basic Indicator Approach (BIA) will not be subject to the assessment process outlined in this document. Institutions adopting the BIA are encouraged to comply with the guidance set out in the Sound Practices for the Management and Supervision of Operational Risk¹ (Sound Practices). Assessment of an institution's risk management practices, systems, and controls will take place as part of OSFI's ongoing supervisory examinations.

¹ Sound Practices for the Management and Supervision of Operational Risk, February 2003, available at www.bis.org.



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II. Background

This document outlines the assessment process that applies to institutions adopting the TSA or AMA on the implementation date of the new Basel framework² as well as provides a basis for assessing subsequent applications for these approaches. The draft CAR Guidelines A and A-1 set out the minimum requirements for institutions pursuing TSA or AMA as well as the underlying expectations related to the implementation timetable and parallel reporting period.

Given the limited time prior to the implementation date, institutions should plan to leave sufficient time for the assessment of TSA and AMA applications. Accordingly, the purpose of this note is to advise institutions on the overall assessment process including assessment principles and the key milestones for operational risk implementation under the draft CAR Guidelines A and A-1.

III. Assessment Principles

OSFI proposes an assessment process that will support implementation of operational risk by addressing eight principles.

These principles are as follows:

1. The assessment process will be based on the institution's own analysis and assessment of compliance with TSA or AMA on a fully consolidated basis (i.e., the framework should be consistent with OSFI's supervisory approach), subject to evolving OSFI standards around the measurement of capital for material subsidiaries of institutions.
2. The assessment process has as its key objectives the development of a more risk sensitive measure of capital and better risk management practices around operational risk.
3. The assessment process will support both initial acceptance, as well as ongoing monitoring of compliance with the operational risk minimum requirements, i.e., the assessment process will be dynamic.
4. The assessment process will deliver an ultimate assessment decision that is consistent with the findings and experience of the implementation process, i.e., the process will produce a 'no surprise' assessment decision.
5. The assessment process will promote feedback to institutions in order to support implementation efforts and, where applicable, contingency planning, i.e., the process will support ongoing dialogue with institutions.
6. The assessment process is designed to address the many and varied institution-specific issues and will be able to support any remedial needs as necessary.

² *International Convergence of Capital Measurement and Capital Standards, A Revised Framework*, June 2004.

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7. The assessment process is designed to accommodate future applications subsequent to the implementation of the new Basel framework.
 8. The assessment process will support the design and execution of a supervisory plan with applicable host-country supervisors, and home-country supervisors for foreign bank subsidiaries i.e., the framework will support the Basel Committee's *Cross-Border Principles for Basel II Implementation*³ (particularly Principle 6).

IV. Assessment Process & Milestones

The key milestone that anchors the assessment process is the start date for final or 'live' capital reporting under Pillar 1 of the new Basel framework (the Implementation Date), which is the beginning of fiscal year 2008 (i.e., November 1, 2007).⁴

While this date determines the overall assessment timeline for institutions, OSFI recognises that it will be important to provide institutions with other interim milestones for planning TSA & AMA implementation. Consequently, OSFI will refer to the following additional milestones within the assessment process. It should be noted that for future applications, the milestones will remain the same but the dates will be revised in consultation with the institution.

³ *High-level principles for the cross-border implementation of the New Accord*, August 2003, available at www.bis.org.

⁴ For institutions with fiscal year-ends aligned with calendar year-ends, the Implementation Date will be January 1, 2008.

Table 1: Assessment Process Milestones for TSA & AMA

	Milestone	Applicable Institutions	Description	Latest Possible Date for Completion (By fiscal YE)
Application	Formal Application Date	All institutions implementing TSA or AMA	An institution submits its formal application to OSFI.	Feb.1, 2006 (Oct. 31 YE) Apr. 1, 2006 (Dec. 31 YE)
	Parallel Reporting Start Date	Institutions implementing IRB or AMA	An institution commences its parallel reporting.	Aug. 1, 2006 (Oct. 31 YE) Oct. 1, 2006 (Dec. 31 YE)
Pre-Implementation	Updated Self-Assessment Date	All institutions implementing TSA or AMA	An institution will submit an updated self-assessment.	May 1, 2007 (Oct. 31 YE) Jul. 1, 2007 (Dec. 31 YE)
	Conditional Acceptance Date	All institutions implementing TSA or AMA	An institution will be conditionally approved, subject to an updated self-assessment.	Aug. 1, 2007 (Oct. 31 YE) Oct. 1, 2007 (Dec. 31 YE)
Implementation & Initial Monitoring	Implementation Date	All institutions implementing TSA or AMA	The start date for the new Basel framework.	Nov. 1, 2007 (Oct. 31 YE) Jan. 1, 2008 (Dec. 31 YE)
	Formal Acceptance Date	All institutions implementing TSA or AMA	An institution will receive formal acceptance of their proposed approach (TSA or AMA as applicable).	Dec. 31, 2008 (Oct. 31 YE) Feb. 28, 2009 (Dec. 31 YE)
	End Date for Monitoring Period	All institutions implementing TSA or AMA	The expiry date for the Monitoring Period.	Oct. 31, 2010 (Oct. 31 YE) Dec. 31, 2010 (Dec. 31 YE)

Given the principles, terminology, and milestones outlined above, OSFI proposes an assessment process that is broken into three key stages or “phases”. These are presented below and referenced to the applicable milestones.

Phase 1: Application Process (Until March 31, 2006)

Prior to its formal application, institutions are expected to perform sufficient analysis for project planning and execution purposes. Institutions are expected to have documented their key project planning activities, as well as commenced execution of project plans that require sufficient lead times.

All institutions applying for TSA or AMA should include, as appropriate, information on applicable domestic subsidiaries that also intend to apply for TSA or AMA, in one consolidated application package. The application package should include:

- A cover letter from senior management setting out the status of the institution's implementation effort and level of adherence to the minimum requirements, including those parts of implementation not yet finalised, as at the applicable Formal Application Date. The letter must also include information on the nature of any and all representations made to the Audit and Risk Committees of the Board in respect of implementation;
- A self-assessment against the minimum requirements using a standard self-assessment template. The self-assessment template will be provided by OSFI;
- A description of all work related to Basel II operational risk implementation that will be required by internal audit in respect of an institution's adherence to the minimum requirements. Additionally, where internal audit work is performed, the internal auditor's opinion must also be included as part of the application package;
- A rollout plan (or updated rollout plan if submitted in 2004); and
- A description of the intended partial application of TSA and AMA including a list of all business activities or legal entities adopting an approach that differs from the main operational risk approach implemented by the institution. Refer to Chapter 6 of the draft CAR Guideline A and Chapter 7 of the draft CAR Guideline A-1 for the requirements surrounding the partial use of TSA and AMA.

Phase 2: Pre-Implementation (April 1, 2006 to October 31, 2007)

Pursuant to an institution's formal application to OSFI for implementing TSA or AMA, there are three key steps required in this pre-implementation phase leading up to the implementation date. These include parallel reporting by applicable institutions, updated submission of self-assessments and conditional acceptance from OSFI.

The parallel reporting period applies to all institutions implementing an IRB approach to credit risk or an AMA to operational risk. Parallel reporting involves institutions reporting on the new capital calculations for five quarters prior to the implementation date. OSFI recognises that this five-quarter period will provide a critical amount of time for institutions to complete implementation. Institutions implementing the Standardized Approach to credit risk and the BIA

or TSA to operational risk can also participate in parallel reporting for two quarters prior to implementation date.

Institutions will be required to submit an updated self-assessment by May 1, 2007 (or July 1, 2007 for December 31 fiscal year-end). In addition, this second submission will require the institution's internal audit function to provide an independent review of the institution's updated self-assessment to OSFI.

OSFI recognises the need to signal its assessment decision in advance of the Implementation Date. Upon receipt of an institution's updated self-assessment, OSFI will communicate its Conditional Acceptance of the proposed operational risk approach (TSA or AMA, as applicable). The target date for this Conditional Acceptance is August 1, 2007 (or October 1, 2008 for December 31 fiscal year-end).

During Phase 2, institutions will be expected to conduct their respective implementation efforts consistent with the most recent roll out plan submitted to OSFI. Where applicable, OSFI will notify institutions of material issues that are identified throughout this process.

Phase 3: Implementation & Initial Monitoring (November 1, 2007 to October 31, 2010)

Phase 3 begins on the Implementation Date, November 1, 2007 (or January 1, 2008 for December 31 fiscal year-end) and includes a post-implementation period of three years.

OSFI will use the first year of this post-implementation period to monitor and evaluate the institution's adherence to the operational risk minimum requirements. After this time, OSFI will reconfirm its conditional acceptance, as appropriate, to institutions with a Formal Acceptance. The target date for Formal Acceptance is December 31, 2008 (or February 28, 2009) or earlier, as appropriate.

During the first year post-implementation, prior to receiving Formal Acceptance, an institution will be permitted to report on the accepted operational risk approach(es) (TSA or AMA) for Pillar 1 operational risk regulatory capital reporting purposes consistent with the terms of the conditional acceptance.

For three years following the Implementation Date, OSFI will conduct monitoring through periodic reviews of an institution's adherence to the minimum requirements. In addition, where there are material changes to the institution's operational risk exposure, institutions will be expected to undertake a review of their application and compliance with the minimum requirements and make this available to OSFI for its review.