A. Introduction

Deutsche Börse Group (DBG) welcomes the opportunity to comment on BCBS consultative document "Operational risk- Revision to the simpler approaches" issued in October 2014.

DBG is operating in the area of financial markets along the complete chain of trading, clearing, settlement and custody for securities, derivatives and other financial instruments and as such mainly active with regulated Financial Market Infrastructure providers.

Among others, Clearstream Banking S.A., Luxembourg and Clearstream Banking AG, Frankfurt/Main, who act as (I)CSD[1] as well as Eurex Clearing AG as the leading European Central Counterparty (CCP), are classified as credit institutions and are therefore within the scope of the European Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR) which transposed i.a. the Basel III rules into European law. Clearstream subgroup is supervised on a consolidated level as a financial holding group.

Moreover, Eurex Clearing AG and European Commodities Clearing AG, who both acts as CCPs with an authorisation under the Regulation (EU) No. 648/2012 (EMIR) which transposed the CPMI-IOSCO principles for financial market infrastructures related to CCPs into EU-law, have to respect the capital requirements for operational risk based on CRD IV and therefore indirectly under the Basel III rules.

All our group entities in scope of CRD/CRR or EMIR and therefore the Basel III rules are offering limited – if at all - banking activities ancillary to their function as Financial Market Infrastructure (FMI). In order to operate as a Financial Market Infrastructure and in line with the dedicated regulatory framework (e.g. CPMI-IOSCO principles for financial market infrastructures as of April 2012) as well as generally recognised business practices, the business model of our group entities is risk averse.

While the financial risks resulting from credit, counterparty or market risks is in general low at our group companies, operational risks is the driving risk factor which receives the appropriate attention.

Although the Clearstream companies are using the AMA we do want to contribute to the current consultation as the question of the appropriate basis for the capital

[1] (International) Central Securities Depository

charge for operational risk is crucial to the companies of our group and the two CCPs are currently using the BIA.

The document at hand contains a management summary in part B and specific answers to the questions raised in part C.

B. Management Summary

In setting up the Basel II framework and including a dedicated capital charge for operational risks, the financial industry, the global supervisors and a lot of risk experts have discussed the appropriate indicator over almost a decade before the final framework was set up in 2004. The model is now in use for less than 10 years and although it may have weaknesses, it has also proven to capture at least the bulk of the risk at the majority of banks using the simple approaches. Also the AMA is not always leading to the correct picture of the risk and validating the model parameters is quite often a real challenge.

As such, a proper and thorough review of the approaches to capture operational risks in general seems to be reasonable. However, taking the intense discussion during the late 90s and the early years of the 21st century into account, this should be done carefully and with sufficient time to discuss, validate (via QIS) and calibrate any potential change. A quick change without proper justification is only changing from weakness A to possible weakness B without real improvement but with substantial allocated costs.

Having said this, in more detail we support the approach of the BCBS to further simplify the approaches and – in case the underlying proof is robust enough – to merge the simple approaches to just one simple approach and one advanced approach (AMA). We in general support the aim of the Committee to have an appropriate balance between simplicity, comparability and risk sensitivity. We want to add the principles of proportionality and especially stability of the approaches. The current focus of regulators to capture the risks in the right manner unfortunately leads to (too) frequent changes, unpredictability of the regulatory framework, sunk cost and high efforts as well as legal uncertainty and a high probability of misunderstandings and incorrect applications following the complexity of the rule set (see our comments of 11 October 2013 to the BCBS #258 consultation "The regulatory framework: balancing risk sensitivity, simplicity and comparability").

In our view, there is no real proof that the current indicator did not capture the operational risk appropriately or at least, that any other indicator would do better. Moreover, as there is no proof that linearity of risk in relation to the indicator is adequate, we also doubt that increasing risk or decreasing risk with the underlying indicator can be demonstrated regardless of individual cases. As such, the proposed approach of capital charges in brackets is adding complexity while it has not proved being more risk sensitive. In addition, with the different approaches on charging systemic importance, we see a tendency to overreact on the topic "to big to fail" and ignoring benefits resulting from size (including the ability to employ sufficient quality and quantity of staff dealing with risks). On the other hand we nevertheless agree that risks also **may** increase along size as a matter of increasing complexity. However, we do want to point out that in our view the approach with an increasing alpha by layer is not reflecting the principle of proportionality as it does not differentiate between different business models.

Interest income is driven by various factors and it is mainly related to financial risk. Interest income in general is not THE indicator for operational risk and as interest rates vary over time, gross interest figures in our mind would be for sure the wrong indicator. We therefore agree to the approach of using net interest income.

However, we see similar arguments for fee income and expenses. Fee expenses are in principle directly related to fee income and there are even dedicated elements of fees passed through from service providers to clients (e.g. exchange fees, custodian fees, etc.). This is properly reflected in most accounting standards which show interest and fee expenses and income gross but also net interest income and net fee income. While we nevertheless agree that fees paid are related to external services which may add operational risks, we disagree to the double charge for economically passed through expenses. This is not only true for fees but also for other operating expenses. While we understand the slightly higher complexity of such a treatment we clearly see the benefit of making the model more risk sensitive. In this regard, it is important to balance out differences coming from different accounting standards in order to have the same charge for same business independent form accounting treatment. This is e.g. true for the handling of own work capitalised (mainly own developed software).

We are very sceptical for the usage of the proposed financial component. Efficient trading strategies with efficient controls would lead to high charge for operational risk.

Poor strategies which lead to a close to zero net P&L on the trading book or the banking book do not receive any relevant capital charge at all (though missing controls could be the reason) and very poor results are again charged. The capital charge in that situation is in addition (a) penalising the loss a second time and (b) extrapolating the loss as charge for the future (next three years). Contrary to our position to the net interest income (in support to the proposal) and the need to correct fee income passed through, we could imagine using the sum of trading and banking book income and losses. However, in order not to overcharge trading results being in addition also reflected – at least partially – in the market risk capital charge, a factor of less than 1 could be introduced to keep the charge in a reasonable range.

C. Response to the questions raised

1. Are there any other weaknesses in the existing set of simple approaches that should be addressed by the Committee?

We have not come across any material weakness which requires from our point of view a change of the current approaches. However, as we are not in the position to assess the appropriateness of the results across banks, we of course cannot judge this for situations outside our group.

2. Does a single standardised approach strike an appropriate balance across the Committee's objectives of simplicity, comparability and risk sensitivity?

From our limited insight in the use of the simple approaches elsewhere, we clearly agree that one simple approach should be sufficient and is in general following the Committee's objectives. As most likely all simple approaches will have weaknesses with regards to risk sensitivity, we do not see a benefit from having two or more approaches being similar but adding complexity. This is even more true when taking into account the information given by the Committee hat the different alpha factors do not capture adequately the risk differentials in the business lines and allocating p&l figures to the regulatory business lines is adding complexity per se.

However, also the principle of proportionality needs to be taken into account especially as the Basel framework is the blue print for national rules which will apply also to very small banks. In addition, differences in the accounting treatment need to be

equalised to some extent and THE simple approach needs to be adequate as such. We therefore agree to use only one simple approach but disagree to the way it is currently proposed by the BCBS.

In more detail, we see the need to adjust the proposed approach in the following areas:

- The Business Indicator should be adjusted as follows:
  - We have no comment on the interest component and agree to the proposed change although we see limited impact if at all;
  - The services component should be corrected by the amount of fee expenses and other operating expenses passed through and therefore captured in the current proposal twice (this is to be done in a harmonised way ignoring accounting differences and legal differences in the way certain amounts are passed through; this does not affect mark ups). In this regard we disagree to the statement of fees paid and received being not (at all) tied up to each other in paragraph 20 of the consultative document;
  - Own work capitalised should not be charged multiple times (first cost, second capitalisation income and third depreciation cost) but only being captured via depreciation;
  - It should be clarified, that depreciation is included in the other operating expenses and clear guidelines what consist of other operating expenses should be given in order to avoid different understanding depending on accounting standards (e.g. in the Council Directive 86/635/EEC "general administrative expenses" [including "staff costs" and "other administrative expenses"] , "Value adjustments in respect of tangible and intangible assets" and "other operating charges" are separated points which we believe are targeted all together in the Committee's proposal as belonging to "other operating expenses");
  - We cannot judge the impact of the inclusion of the other operating expenses in combination with the simplifications of some adjustments made to the indicator in the past and the revised alpha factor. As such, we do not comment on this as it may or may not be appropriate;

- The financial component should not be based on net p&l. Instead the sum of income and losses / expenses should be taken into account multiplied by a factor less than 1. Net p&l is not risk sensitive at all as risk is driven by the size of the trading activities and the effectiveness of controls and not be the success of the trading strategies. In principle the average size of the trading volume and the average size of the banking book (with a lower weight) may be the right indicator here. However, as this is clearly adding complexity to the indicator we rather propose the method as stated above;
- While we understand the rationale behind the proposal of the BCBS on the financial component, we clearly see the disadvantage of non-risk sensitive out-weighting the advantages of simplicity. The argument of net presentation is also true for net fee income but in this regard not followed by the BCBS. It is to be noted, that income from the banking book is usually clearly separated from related expenses (i.e. via impairment losses). We do not agree to capture the operational risk of the trading book mainly via the related other operational expenses (i.e. the cost for traders and the back office);
- The targeted changes for capital charges for operational risk resulting out of the banking book are in practise only including value changes (impairment losses). This does not seem to be a major change and we cannot judge this. However, it needs to be secured that the interest income and expenses out of the banking book are not included twice and as such we clearly favour to keep this in the interest component on a net basis or even leave the banking book unchanged but add the dividend and similar income to the interest component.

3. Are there any further improvements to the BI that should be considered by the Committee?

As stated in our comment to question 2 and our general remarks in part B of this paper, we in general do not see the need to change the current BIA. However, if deemed to be necessary based on well substantiated facts, the comments made in our answer to question 2 should be taken into account.

4. What additional work should the Committee perform to assess the appropriateness of operational risk capital levels?

The proposed changes to the current BIA should only be done in case the new approach shows a better fit. As the discussion in the Basel II process has shown that it is very difficult to judge the right amount of capital charge as well as the appropriate indicator to capture it, it will be very challenging to demonstrate this. As such, the changes imposed need to clearly focus on simplicity and stability of the framework. Especially the calibration of the layered approach should only be done after a series of QIS rounds which proof its effectiveness. Especially the underlying assumption for increasing risk with increasing indicator needs careful evaluation and adequate proof.

5. Are there any other considerations that should be taken into account when establishing the size-based buckets and coefficients? How many BI buckets would be practical for implementation while adequately capturing differences in operational risk profiles?

As stated in the management summary in part B of this paper we are not in the position to judge the risk behaviour relative to the increase of the underlying risk indicator. We however belief that any kind of behaviour is possible depending on business model, size category, economical circumstances etc. and that the bucket approach here is adding complexity without real proof of the relationship of the indicator and the resulting risk. However, as the simplicity of the indicator may not fully capture (a) all relevant corrections useful, (b) complexity risks as well as low risk business models (proportionality) and (c) overestimate due to its tendency to a "gross" approach at least for the service component the bucket approach may be counterbalancing these effects to some extent. In this case however, we neither agree to a coefficient of substantially above 20% nor to a high number of layers. In principle 3 to 4 layers seem to be sufficient. Final ranges and coefficients can however only be fixed after (i) fixing the indicator as such, (ii) sufficient data sampling (QIS) and evaluating and (iii) a second round of consultation afterwards.

6. Are there any other considerations that should be taken into account when replacing business lines with size-based buckets?

There is no replacement of business lines for the BIA. Here only a generic alpha of 15% is replaced by the buckets and the indicator is modified on top. Also for the Standardised Approach, not only the business lines are replaced by the buckets but also the indicator as such. Beside this more technical comment, we cannot comment on the question as such as this needs to be validated with statistical data.

7. Could there be any implementation challenges in the proposed layered approach?

We see no material implementation challenges. However, any change is leading to implementation efforts and costs and those need to be carefully balanced against any assumed benefit. So far, we do not see a real benefit to replace current BIA with the new SA. Furthermore, the implementation challenges are more related to capturing the relevant indicator than to calculate the risk capital charge.

8. Do the issues of high interest margin and highly fee specialised business in some jurisdiction need special attention by the Committee? What could be other approaches to addressing these issues?

The general approach of the Committee to balance out simplicity and comparability is well appreciated. This however leads to the fact that some very unique or specific components will never be reflected adequately. We have already expressed that the elements of proportionality and stability are to be added to the Committee's principles and want to reinforce this in that context. We recognise that the analysis for the need to special treatment of very high or very low NIM as well as e.g. highly fee related business should be looked at. However, instead of looking for alternative approaches and possible adjustments we rather recommend to incorporate value adjustments of the banking book and the loan portfolio as well as dividend and other non-interest related income from the banking book into the NIM and take out the banking book completely from the financial indicator (see also our comment above to question 2).

Moreover, we continue to have doubt on the inclusion of the sum of fee income and fee expense rather than the absolute amount of net fees in the service indicator. In case the current approach (with the corrections requested in our response to question 2) is kept, there are two other options to solve the fee issue:

a. Adjust the coefficient / the bucket ranges of the proposed approach (simple and standard) or

b. Introduce decreasing buckets for the service indicator depending on size (i.e. with higher amounts of the value of the service indicator, the amount above certain thresholds are not weighted 100%). This is creating more complexity but at least leading to a unique indicator.

9. What would be the most effective approach to promoting rigorous operational risk management at banks, particularly large banks?

The difficulties to quantify the adequate capital charge for operational risk clearly show that regardless of the approach measurement of operational risk is and remains difficult if possible at all. Also the AMA shows clearly weaknesses and in case of operational risk materialising neither the approach to link to the results of the past nor the VaR estimates of something happening every x years may cover the loss.

Consequently, more granular standards and requirements will only make the framework less simple and less comparable but not solve operational risk issues. As such, we see the most efficient way forward within pillar II and ongoing supervision. Only the constant dialogue with the supervised entities gives sufficient inside into the risk management framework and reveals possible weaknesses. Individual add-ons to the capital charge – or even “discounts” - may than be the right answer to honour or discharge good respectively bad risk management.

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We hope that our comments given are useful in the further process and are taken up going forward. We are happy to discuss any question related to the comments made.

Eschborn, 06 January 2015

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