

event database. The policy must provide for consistent treatment across the institution.

S 18. The institution must establish appropriate operational risk data thresholds.

S 19. Losses that have any characteristics of credit risk, including fraud-related credit losses, must be treated as credit risk for regulatory capital purposes. The institution must have a clear policy that allows for the consistent treatment of loss event classifications (e.g., credit, market, or operational risk) across the organization.

The key to internal data integrity is the consistency and completeness with which loss event data capture processes are implemented across the institution. Management must ensure that operational risk loss event information captured is consistent across the business lines and incorporates any corporate functions that may also experience operational risk events. Policies and procedures should be addressed to the appropriate staff to ensure that there is satisfactory understanding of operational risk and the data capture requirements under the operational risk framework. Further, the independent operational risk management function must ensure that the loss data is captured across all material business lines, products types, event types, and from all significant geographic locations. The institution must be able to capture and aggregate internal losses that cross multiple business lines or event types. If data is not captured across all business lines or from all geographic locations, the institution must document and explain the exceptions.

AMA institutions must be able to map operational risk losses into the seven loss event categories defined in paragraph 10. Institutions will not be required to produce reports or perform analysis for internal purposes on the basis of the loss event categories, but will be expected to use the information about the event-type categories as a check on the comprehensiveness of the institution's data set.

The institution must have five years of internal loss data, although a shorter range of historical data may be allowed, subject to supervisory approval. The extent to which an institution collects operational risk loss event data will, in part, be dependent upon the data thresholds that the institution establishes. There are a number of standards that an institution may use to establish the thresholds. They may be based on product types, business lines, geographic location, or other appropriate factors. The Agencies will

allow flexibility in this area, provided the institution can demonstrate that the thresholds are reasonable, do not exclude important loss events, and capture a significant proportion of the institution's operational risk losses.

The institution must capture comprehensive data on all loss events above its established threshold level. Aside from information on the gross loss amount, the institution should collect information about the date of the event, any recoveries, and descriptive information about the drivers or causes of the loss event. The level of detail of any descriptive information should be commensurate with the size of the gross loss amount. Examples of the type of information collected include:

- Loss amount;
- Description of loss event;
- Where the loss is reported and expensed;
- Loss event type category;
- Date of the loss;
- Discovery date of the loss;
- Event end date;
- Management actions;
- Insurance recoveries;
- Other recoveries; and
- Adjustments to the loss estimate.

There are a number of additional data elements that may be captured. It may be appropriate, for example, to capture data on "near miss" events, where no financial loss was incurred. These near misses will not factor into the regulatory capital calculation, but may be useful for the operational risk management process.

Institutions will also be permitted and encouraged to capture loss events in their operational risk databases that are treated as credit risk for regulatory capital purposes, but have an underlying element of operational risk failure. These types of events, while not incorporated into the regulatory capital calculation, may have implications for operational risk management. It will be essential for institutions that capture loss events that are treated differently for regulatory capital and management purposes to demonstrate that (1) loss events are being captured consistently across the institution; (2) the data systems are sufficiently advanced to allow for this differential treatment of loss events; and (3) credit, market, and operational risk losses are being appropriated in the correct manner for regulatory capital purposes.

The Agencies have established a clear boundary between credit and operational risks for regulatory capital purposes. If a loss event has any element of credit risk, it must be treated as credit risk for regulatory capital purposes. This would include all credit-

related fraud losses. In addition, operational risk losses with credit risk characteristics that have historically been included in institutions' credit risk databases will continue to be treated as credit risk for the purposes of calculating minimum regulatory capital.

The accounting guidance for credit losses provides that creditors recognize credit losses when it is probable that they will be unable to collect all amounts due according to the contractual terms of a loan agreement. Credit losses may result from the creditor's own underwriting, processing, servicing or administrative activities along with the borrower's failure to pay according to the terms of the loan agreement. While the creditor's personnel, systems, policies or procedures may affect the timing or magnitude of a credit loss, they do not change its character from credit to operational risk loss for regulatory capital purposes. Losses that arise from a contractual relationship between a creditor and a borrower are credit losses whereas losses that arise outside of a relationship between a creditor and a borrower are operational losses.

## B. External Data

### Supervisory Standards

S 20. The institution must have policies and procedures that provide for the use of external loss data in the operational risk framework.

S 21. Management must systematically review external data to ensure an understanding of industry experience.

External data may serve a number of different purposes in the operational risk framework. Where internal loss data is limited, external data may be a useful input in determining the institution's level of operational risk exposure. Even where external loss data is not an explicit input to an institution's data set, such data provides a means for the institution to understand industry experience, and in turn, provides a means for assessing the adequacy of its internal data. External data may also prove useful to inform scenario analysis, fit severity distributions, or benchmark the overall operational risk exposure results.

To incorporate external loss information into an institution's framework, the institution should collect the following information:

- External loss amount;
- External loss description;
- Loss event type category;
- External loss event date;
- Adjustments to the loss amount (i.e., recoveries, insurance settlements,