

# OFFICIAL INFORMATION OF THE CZECH NATIONAL BANK

of 29 December 2010

regarding the prudential rules for banks, credit unions and investment firms

## **The Application for Prior Approval to Use a Special Approach**

The Czech National Bank hereby provides the following information with regard to Article 80 (1) of Decree No. 123/2007 Coll., stipulating the prudential rules for banks, credit unions and investment firms, as amended (hereinafter the “Decree”):

Annexes to the application for selected special approaches are understood as follows:

### **I. In the case of an approach for the calculation of the capital requirement to cover credit risk in the investment portfolio and dilution risk based on an internal rating (IRB Approach):**

1. Documentation on the organisation, strategy, system and processes of credit risk management, which shall include:
  - a) the current strategy for managing credit risk, including the planned use (application) of various rating systems, and possibly other materials containing the liable entity’s conceptual plans in the field of credit risk management, always including information as to when these documents started to apply and who they were approved by;
  - b) an overview of the organisational structure, particularly the powers, responsibilities, links and information flows when providing loans and managing credit risk, including the function of any committees involved in the management and including the internal audit department’s powers and responsibilities;
  - c) an overview (list) of audits, both of the assurance and the consulting nature, and full reports from these audits, if they were focused on credit risk management or on the use of the IRB Approach, conducted during the two-year period before the submission of the application for approval;
  - d) minutes from the meetings of the liable entity’s management and advisory bodies whose activities are connected with the management of credit risk, held during the two-year period before the submission of the application for approval, including all of the documents that were available to the members of the individual committees at the last three sessions of every committee;
  - e) documents demonstrating regular internal reporting (notification) of the extent of credit risk undertaken and information about the internal rating system (e.g. the last three reports for each report type), stating the periodicity and time at which the report is available and who the report is intended for;
  - f) the powers, responsibilities and links of the parties involved in allocating ratings, including the possibility of an expert judgment overriding the result produced by the model;
  - g) the powers and responsibilities of the parties involved in developing and approving models;
  - h) an overview showing the manner in which the validation process is conducted, including the manner in which estimates of risk parameters are back-tested and stress-

tested, and the manner in which its evaluation and conclusions are used for further improvement of the IRB Approach, including the models used.

2. Documentation on the system for measuring credit risk, which shall include:
  - a) the categorisation of exposures and the criteria thereof (including the creation of pools of exposures), the definition of the portfolio's target segments for the use of individual rating methods, and the internal definitions used (including the definition of default);
  - b) an overview of all models that are used for individual categories of exposures or, as the case may be, for individual portfolios; this means an explanation as to which categories of exposures, persons and geographical areas are covered by the individual rating systems or, as the case may be, by the modelling tools used in the context of rating systems; the overview of models or rating systems shall be produced in a clear (e.g. graphic or tabular) form;
  - c) an overall description and explanation of all methodologies and procedures used in the context of the IRB Approach, which means in particular:
    1. a description of the rating methods and rating scales used (e.g. the features of the main scale and other supplemental scales), quantitative and qualitative assessments and a description of the types of data used;
    2. a description of the type of models used (if used), their architecture and theoretical foundations, the models' fundamental assumptions (e.g. criteria for selecting independent variables, a definition of the conditions under which the model cannot be used), a description of the technical implementation of the models (the technical equipment and software used);
    3. documentation on the development of models, including a description of the external and internal data used, their quality control (check) and the selection of parameters, the procedure for updating historical data, a substantiation of the applicability and appropriateness of the methods and data;
    4. the methodology for calculating the realised values of risk parameters;
    5. a specification of the estimates of the risk parameters used to calculate the capital requirement, including for internal purposes (if the approaches differ), and the rules governing their estimation (including the manner and frequency of the involvement of the appropriate senior employees);
  - d) a description of the tools (techniques) that the liable entity uses and applies to reduce the credit risk capital requirement, in particular:
    1. a description of the types of funded credit protection instruments and the manners in which the liable entity applies and enforces them, including the internal requirements laid down on these instruments;
    2. a description of the types of instruments used as unfunded credit protection and the manners in which the liable entity applies and enforces them, including the internal requirements laid down on these instruments;
    3. a list of the information kept regarding the collection of security for the individual exposures;
  - e) overall information about the structure of the liable entity's information technology, covering the system and database environment used, the existence and use of special software for credit risk management, particularly in the field of statistical and mathematical calculations for credit risk measurement.
3. Documentation on the implementation procedure, including the internal rules and ensuring of procedures for the following activities:

- a) general directions of further improvement and development of the credit risk measurement methodology (rating methodology);
- b) implementation of the information technology infrastructure for credit risk measurement and management;
- c) the manner of further training of employees, including senior employees, internal audit department's employees and persons involved in the independent validation of internal rating systems;
- d) a description of the transition from an existing rating system to a new system based on current transactions and its evaluation, if such a transition has been effected;
- e) a description of any use of the Standardised Approach as part of the IRB Approach in terms of both substance and time;
- f) principles and procedures to be followed when changing models, including procedures to be followed when changing the extent of the use of models, the factoring of significant changes arising from, for instance, the introduction of new activities, processes and systems into models;
- g) the procedure adopted for further ongoing assessment of models' appropriateness, including the plan of audits focusing on models;
- h) the areas in which outputs of the IRB Approach are used (use test), particularly for providing and monitoring loans, creating value adjustments, calculating internally determined capital, specifying risk margins, internal and external reports, including data about the formal internal adoption of a new rating system and its implementation by the liable entity;
- i) a description of the manner in which the IRB Approach is used when actually calculating the capital requirement, in particular, the documentation and substantiation of all simplifications in the calculation or deviations between the values used for regulatory purposes (capital requirement calculation) and the values used for management purposes.

The implementation process shall be divided at least into the classes of exposures specified by the Decree, into entities in a regulated consolidated group, branches abroad (if relevant) and risk parameters.

In addition, a list of all the portfolios that are to be permanently excluded from the IRB Approach shall be attached to the documentation on the implementation procedure. These portfolios shall be precisely quantified from various points of view (e.g. the number of counterparties, the volume of credit transactions, aggregation of the value of exposures and risk-weighted exposures, the degree of risk). The liable entity shall state its rules and grounds on which the given portfolios are excluded from the IRB Approach.

4. Self-assessment for the IRB Approach, which shall represent an assessment (described from the liable entity's perspective) of the state of preparedness for introducing the IRB Approach. The self-assessment shall contain a general part and a specific part. The general part of the self-assessment shall include an overall view from the consolidated level perspective and shall always contain an assessment of:
  - a) the appropriateness of the strategy and organisational structure from the perspective of the requirements for a management and control system in the field of credit risk (internal governance);
  - b) the sufficiency and adequacy of the resources allocated to the rating system, including human resources;
  - c) the mutual links between the methodologies used;
  - d) the comparability of data and methodologies in the field of credit risk in the group;

- e) the interconnectedness of the information systems in the management of credit risk in the group;
- f) the compatibility of the information technologies in the management of credit risk in the group.

If the application is not for the purposes of fulfilling the prudential rules by liable entities on a consolidated basis, the general part of the self-assessment shall include an overall view from a level corresponding to the place (level) of the submission of the application. The specific part of the self-assessment shall contain a judgment of to what extent all of the requirements for the IRB Approach specified by the Decree are satisfied. Data on identified shortcomings and errors and a plan for their elimination and achieving compliance with the requirements of the Decree shall form an integral part of the self-assessment.

- 5. A list of all the relevant external documentation and internal documents that are available at the liable entity (upon request) and that relate to the management and measurement system for the risk to which the liable entity wishes to apply the special approach.

**II. In the case of an approach for the calculation of the capital requirement to cover specific interest rate risk and equity risk in the trading portfolio and for market risk based on own models (VaR model):**

- 6. Documentation on the organisation, strategy, system and processes for managing specific interest rate risk or equity risk in the trading portfolio and market risk, which shall include:
  - a) the liable entity's current strategy, including the risk management strategy and other materials containing the liable entity's conceptual plans in the field of managing the specific interest rate risk or equity risk in the trading portfolio and market risk, always including information about when these documents started to apply and who they were approved by;
  - b) an overview of the organisational structure, particularly the powers, responsibilities, links and information flows involved in trading, in the settlement of transactions and in the management of specific interest rate risk or equity risk in the trading portfolio and market risk, including the function of any committees involved in the management;
  - c) an overview (list) of audits, both of the assurance and the consulting nature, and full reports from these audits, if they were focused on market risk management or on the use of the VaR model, conducted during the two-year period before the submission of the application for approval;
  - d) a list of the responsible persons in the relevant departments whose activities are connected with trading and with the management of specific interest rate risk or equity risk in the trading portfolio and market risk;
  - e) the powers and responsibilities of the parties involved in developing and approving models;
  - f) minutes from the meetings of the liable entity's management and advisory bodies whose activities are connected with the management of specific interest rate risk or equity risk in the trading portfolio and market risk (including minutes from the meetings of the audit committee, if established), held during the two-year period before the submission of the application for approval, including all of the documents

that were available to the members of the individual committees at the last three sessions of every committee;

- g) a description of the powers and responsibilities of the internal audit department, a list of persons performing internal audit, their qualifications and professional experience;
- h) documents demonstrating regular internal reporting (notification) of exposures to specific interest rate risk or equity risk in the trading portfolio and market risk, and examples of all corresponding reports on the extent of the risk undertaken by the liable entity relating to the same date (e.g. the last three reports for each report type), stating the periodicity and time at which the report is available and who the report is intended for;
- i) an overview showing the manner in which the validation process is conducted, including the manner of back-testing and stress-testing, and the manner in which its evaluation and conclusions are used for further improvement of the VaR model, including the models used;
- j) as regards back-testing:
  - 1. a description of the basic procedure for calculating the change in the fair value of the portfolio, including an explanation of the manner in which intraday trading positions and fees are factored into the trading results;
  - 2. individual daily changes in the fair value of the portfolio as calculated during the back-testing period (at least for 1 year);
  - 3. a specification of the holding period that the determination of the VaR value is based on;
  - 4. individual daily VaR values as calculated during the back-testing period (at least for 1 year). Any increase or decrease factored into the VaR values calculated by the model shall be mentioned separately with an explanation, e.g. increasing the calculated VaR value by the product of the nominal value and conversion factor (add-on) for gamma risk arising in the case of short positions in options;
  - 5. the results of investigation into the causes of instances of overshooting, e.g. cases where changes in the fair values of the portfolio were greater than the calculated VaR values, or cases where there was an accumulation of exceptions in a given period;
  - 6. the results of back-testing at lower aggregation levels, if such testing is conducted, e.g. relating to a part of the portfolio or to a selected group of risk factors;
- k) as regards stress testing:
  - 1. a description of the methodology, scope and frequency of testing;
  - 2. a description of the stress scenarios;
  - 3. a list of the quantities against which the size of acceptable loss in the event of a crisis situation is measured, e.g. planned profit or capital;
  - 4. a report on the results of the last stress test;
- l) overall information about the structure of the liable entity's information technology, covering the system and database environment used, the existence and use of special software for market risk management, particularly in the field of statistical and mathematical calculations for market risk measurement. This information shall include, at least:
  - 1. a list of any software (including its manufacturer, name and version number) used in the trading and transaction settlement departments for the purpose of recording transactions and positions and for the purposes of valuating and aggregating positions. The list shall also contain a specification of the instruments or types of transactions for which the given software is used;

2. an overall summary (diagram) showing the data flows from the recording of transactions and positions, valuations, the inputting of data from the valuation model and risk position aggregation procedures up to the resulting calculations performed by the own model, including a specification of the times at which the data flow is closed so that the data can be used for trading;
  3. a diagram showing the data flows from the recording of positions up to the change in the value of the portfolio calculated using the valuation models, a diagram showing the flow of data from various sources of market data into the information systems used by the liable entity, and a description of the transfer and control methods used by the liable entity;
  4. a diagram showing the flow of data from various sources of market data into the information systems used by the liable entity, and a description of the transfer and control methods used by the liable entity;
  5. a diagram showing the data flows when recording transactions and positions and specifying the transfer method (manually inputted data, file transfer, including a specification of the possibility of manual interventions), and control (checks) exercised at system interfaces (comparison, credibility check); the diagram shall include the data flows in the following areas and describe any differences (what operations are recorded and in what manner, e.g. after the performance of what tests, in what databases):
    - a) recording of transactions and positions for trading purposes;
    - b) recording of transactions and positions for risk management purposes;
    - c) recording of transactions and positions for accounting purposes;
  6. a diagram showing the flow of data for the stochastic model from various sources of market data into the information systems used by the liable entity, and a description of the transfer and control methods used by the liable entity, including a list of data sources and selection methods;
  7. a data flow diagram for the resulting calculations of the VaR value.
7. Documentation on the system for measuring specific interest rate risk or equity risk in the trading portfolio and market risk, which shall include:
- a) an up-to-date and complete overview of all activities concerning the trading portfolio, business objectives and strategy in the individual groups of the trading portfolio products and also an overview of any significant changes affecting these trading activities in the last two-year period before the date of the submission of the application for approval, and an overview of the changes being prepared for the one-year period after the submission of the application for approval;
  - b) the structure of the portfolios to which trading portfolio instruments are allocated;
  - c) an overview of all methods used to measure specific interest rate risk or equity risk in the trading portfolio and market risk, and the theoretical foundations of the methods;
  - d) for each valuation model:
    1. the formula for calculating the value of an instrument or position, including explanations of mathematical symbols;
    2. the model's methodological foundations, e.g. the name of the relevant expert publication. If a standard formula is modified, a description of the modifications shall be supplied, too. If the model has been internally developed by the liable entity, its mathematical derivation and a practical example shall be given;
    3. the source from which the values of the parameters used in the practical calculation are acquired. If the inputted parameters themselves are the result of calculations performed by a model, e.g. an estimate of the time structure of interest

- rates in yield curves or an estimate of the structure of implied volatilities, the documentation shall contain the relevant formula and explain the mathematical symbols used;
4. a detailed explanation of the links between the valuation models and various instruments, if several different valuation models are used in parallel to value a group of financial instruments, e.g. also applying further breakdown into groups of instruments. It needs to be stated explicitly whether different valuation models are used in respect of individual financial instruments for trading purposes and for risk measurement purposes;
  - e) for risk factors and aggregation of risk positions:
    1. a list of the risk factors that the model works with;
    2. a description of the procedure used for the decomposition of instruments and their subsequent aggregation (stripping, mapping), explaining the mathematical symbols used. If an aggregation procedure with a different methodological basis is used for a particular instrument, a justification of this procedure shall be given;
    3. a description of the procedure for aggregating positions if the input parameters are missing or if the data are not mutually comparable;
  - f) for the stochastic model:
    1. the basic structures of the model (i.e., model type) – variances and co-variances method, historical simulations, Monte Carlo simulations;
    2. the parameters that will be estimated;
    3. the estimates used, including explanations of the mathematical symbols used;
    4. procedures used to aggregate individual VaR values;
    5. procedures used if input data are missing, if the data are mutually incomparable or if outlying data are used;
    6. procedures for instruments with an illiquid market (e.g. a shortage of data), if it relates to implied volatilities of OTC options;
    7. procedures used for permanent assessment of the adequacy of stochastic methods, particularly the liable entity's procedures to ensure that significantly increased volatility in those risk areas where the liable entity has significant positions is monitored;
8. Documentation on the implementation procedure, including:
- a) the areas in which outputs of the VaR model are used (use test), that is a description of the ways in which the VaR value calculations are used to check limits applying to the VaR value, to determine the capital requirements for supervisory purposes, for back-testing or, as the case may be, in other areas;
  - b) as regards the system of limits, information about whether the limits relating to the specific interest rate risk or equity risk in the trading portfolio and market risk are defined using the VaR model and whether these limits were tested against the results of stress testing, including:
    1. the structure of the limits relating to the given risk;
    2. a description of the procedures used to define and monitor the limits, including the authorization needed to exceed the limits;
    3. a precise definition of the authorization needed to exceed the limits;
    4. the procedure to be followed if the limits are exceeded without authorization; and
    5. the extent of the use of the limits;
  - c) the manner of further training of employees, including senior employees, internal audit department's employees and persons involved in the independent validation of the VaR model focusing on the given risk;

- d) principles and procedures to be followed when changing models, including procedures to be followed when changing the extent of the use of models, particularly procedures to be followed when factoring significant changes arising from, for instance, the introduction of new activities, processes and systems into models, including the last three reports prepared for the purpose of changing the extent of the use of models or for the purpose of the factoring (introduction) of new activities, processes and systems into models (if relevant), or possibly general directions of further improvement and development of the model;
  - e) the procedure adopted for further ongoing assessment of models' appropriateness, including the liable entity's plan of internal audit focusing on the internal system to measure and manage the given risk.
9. Self-assessment, which shall represent an assessment (described from the liable entity's perspective) of the state of preparedness for introducing an approach based on own models. The self-assessment shall contain a general part and a specific part. The general part of the self-assessment shall include an overall view from the consolidated level perspective and shall always contain an assessment of:
- a) the appropriateness of the strategy and organisational structure from the perspective of the requirements for a management and control system to manage the given risk (internal governance in the field of managing the given risk) and the sufficiency and adequacy of the resources allocated to managing the given risk, including human resources;
  - b) the advantages and shortcomings of the valuation model, stochastic model, stress testing and back-testing;
  - c) the advantages and shortcomings of selected risk factors and aggregation procedures, including:
    1. a list of risks that are not satisfactorily captured by the risk factors, e.g. dependence of implied volatility on the strike price in the case of options (volatility smile) or insufficient certainty as to the valuation of instruments in the case of an illiquid market (valuation uncertainty);
    2. a list of instruments or categories thereof for which the special risks are covered insufficiently or not at all;
    3. the advantages and shortcomings of the information system used for the liable entity's own model;
  - d) the comparability of data and methodologies in the group (if relevant);
  - e) the interconnectedness of the information systems in the management of market risk in the group, and the mutual compatibility of the information technologies in the management of market risk in the group (if relevant);
  - f) the sufficiency and adequacy of the resources allocated to the approach based on own models, including human resources.

The specific part of the self-assessment shall contain a judgment of to what extent all of the requirements for the approach based on own models specified by the Decree are satisfied. Data on identified shortcomings and errors and a plan for their elimination and achieving compliance with the requirements defined by the Decree shall form an integral part of the self-assessment.

10. A list of all the external documentation and relevant internal documents that are available at the liable entity (upon request) and that relate to the management and measurement system for the risk to which the liable entity wishes to apply the special approach. For the



purposes of the VaR model, quantitative data shall be given in a time series for the last 6 months with daily data, unless specified otherwise above.

### **III. In the case of the advanced approach to measuring operational risk (AMA Approach):**

11. Documentation on the organisation, strategy, system and processes of operational risk management, which shall include:
  - a) the internally used definition of operational risk, definitions of the event types, losses, business lines or business units for the purposes of operational risk management;
  - b) the liable entity's current strategy, including the risk management strategy and other materials containing the liable entity's conceptual plans in the field of operational risk management, always including information about when these documents started to apply and who they were approved by;
  - c) an overview of the organisational structure, particularly the powers, responsibilities, links and information flows in operational risk management, including the function of the person responsible for operational risk management, any committees involved in operational risk management (stating the current composition of the committees and decision-making powers) and a list of persons in the relevant departments and any committees whose activities are connected with operational risk management;
  - d) minutes from the meetings of the liable entity's management and advisory bodies whose activities are connected with the management of operational risk (including minutes from the meetings of the audit committee, if established), held during the two-year period before the submission of the application for approval, including all of the documents that were available to the members of the individual committees at the last three sessions of every committee;
  - e) a description of the thresholds used in operational risk management, including the level of current thresholds;
  - f) a description of remedial measures in case that the defined procedures or thresholds are not complied with;
  - g) a description of the information systems and of the information database or databases concerning operational risk events and losses, including internal and possibly external data, a description of all interfaces of the relevant information systems or databases, especially for the acquisition of data and reconciliation with data in other systems;
  - h) a list of information kept about operational risk events and their causes, including the areas of application (possibly divided into information for internal purposes and for regulatory purposes, if different);
  - i) a description of the internal validation process, information about departments or third parties that were involved in assessing the model, the final report from the internal validation process, including the results of tests when implementing the model, and a list of the recipients of this report;
  - j) documents demonstrating regular internal reporting (notification) of the extent of the operational risk undertaken and of the operational risk losses, including specific reports on operational risk (the last three reports for each report type), stating the periodicity and time at which the report is available and who the report is intended for;
  - k) an up-to-date list and brief description of activities relating to the area of operational risk that the liable entity does not perform itself and that are performed for the liable entity by another entity within the group or outside of the group (including any performance of internal audit in the area of operational risk by another entity); for every such activity, information shall be provided as to who performs the said activity;

- l) a description of the powers and responsibilities of the internal audit department in the area of operational risk audit, a list of persons responsible for the internal audit of operational risk management, including any audit of the models used, and these persons' qualifications and professional experience;
  - m) an overview (list) of audits, both of the assurance and the consulting nature, and full reports from these audits, if they were focused on operational risk management or on the use of the AMA Approach, conducted during the two-year period before the submission of the application for approval;
  - n) a description of the manner in which operational risk is possibly transferred outside of the liable entity and the techniques used, including a description of their impact on operational risk reduction, principles in the field of insurance, including a description and documentation of insurance taken out in the field of operational risk in the liable entity;
  - o) all other applicable internal regulations and documents concerning operational risk management; e.g. procedures for identifying, monitoring, evaluating and limiting the occurrence or negative impacts of operational risk events, contingency planning.
12. Documentation on the system for measuring operational risk (also referred to as the "model") shall include:
- a) the manner in which the model (models) is (are) used, including a description of what operational risks, losses and business lines or business units are covered by the model (individual models) and how;
  - b) the manner in which data are collected, particularly the principles and methodology (procedures) for mapping events into business lines and event types, including events occurring in central departments or affecting more than one business line, and the minimum threshold(s) for collecting data on operational risk events;
  - c) a description of the models used to measure operational risk, including a description of the estimates of the statistical distribution of input data used, the manner in which internal and external data are used (including thresholds for the inclusion of data in calculations and the manner in which these thresholds are derived), the procedure used to update historical data, a description of the manner in which potential low-frequency events with a major impact are covered, documentation on the use of scenarios and their definitions, the manner in which the business environment and internal control factors or changes in the liable entity's activities are included, documentation of internally developed methods (including their theoretical foundations), references to the sources used (if standard (general) methods are used), documentation on any modifications of standard formulas, an assessment of the applicability and appropriateness of methods; a description and substantiation of the relative proportions of the four basic components of AMA-measurement in the model, and the manner in which they are combined in the model, and a description of the manner in which a quality standard comparable to a 99.9% confidence interval over a one-year period is achieved;
  - d) a description of tools (techniques) that the liable entity possibly uses and intends to apply in order to reduce the capital requirement:
    - 1. measurement and coverage of expected losses (a description of the manner in which expected and unexpected losses are included and differentiated and of the manner in which expected losses are adequately captured by the liable entity's standard procedures);

2. the manner in which correlations or diversification effects are taken into account (documentation – a description of any use of correlations and diversifications, for example, between individual loss categories);
  3. operational risk insurance (principles for applying insurance in the calculation of the capital requirement, overview of the residual terms of the insurance policies and the insurance policies' cancellation terms, documentation on any problems or mismatches regarding the payments of insurance settlement, individual insurance policies, including an evaluation of indemnification, and the overall effectiveness of the use of insurance in operational risk management for the past three years);
  4. other approvable operational risk mitigation techniques (including their impact on operational risk reduction);
  5. others;
- e) overall information about the structure of the liable entity's information technology, covering the system and database environment used, the existence and use of special software for operational risk management, particularly for statistical and mathematical calculations concerning operational risk;
  - f) a description of the allocation of operational risk capital requirements among various entities in the group (if relevant) and the manner in which diversification effects are possibly taken into account when allocating capital requirements among various entities in the group;
  - g) in the case of group models, potential intention to request the competent supervisory authority to assess the fulfilment of the requirements laid down for the use of the AMA Approach for the group as a whole, and a specification of the proposed solution (in particular, what requirements the group intends to fulfil solely on a unified basis);
  - h) any other documents or documentation on the operational risk measurement system (model) that are necessary for assessing the theoretical foundations, logic and architecture of the AMA Approach and of its components, and the fundamental relationships between them in the liable entity.
13. Documentation on the implementation procedure, which contains the internal rules and ensuring of procedures for the following activities within the operational risk management process, shall include:
- a) general directions of further improvement and development of the operational risk measurement methodology;
  - b) implementation of the information technology infrastructure for the purposes of operational risk measurement and management;
  - c) the manner of further training of employees, including senior employees, internal audit department's employees and persons involved in the independent validation of the AMA Approach focusing on operational risk, and a plan for further training of these employees;
- a) principles and procedures to be followed when changing models, including the criteria selected for classification and categorization of changes and including the procedures to be followed when changing the extent of the use of models, procedures to be followed when factoring significant changes (e.g. arising from the introduction of new activities, processes and systems) into models, possibly including the last three reports prepared for the purpose of changing the extent of the use of models or for the purpose of the factoring (introduction) of new activities, processes and systems into models;
  - b) the procedure adopted for the ongoing assessment of models' appropriateness, including the liable entity's plan of audits focusing on the internal system for managing and measuring operational risk;

- c) a description of the manner in which the operational risk management and measurement system is incorporated into the everyday process of risk management (use test).

14. Self-assessment, which shall represent an assessment (described from the liable entity's perspective) of the state of preparedness for introducing the AMA Approach for regulatory purposes. The self-assessment shall contain a general part and a specific part. The general part of the self-assessment shall include an overall view from the consolidated level perspective and shall always contain an assessment of:

- a) the appropriateness of the strategy and organisational structure from the perspective of the requirements for a management and control system to manage operational risk (internal governance in the field of operational risk management);
- b) the resources devoted to the operational risk management and measurement system, including human resources (especially their sufficiency and adequacy);
- c) the methodologies used for the AMA Approach and their mutual relationships;
- d) the extent to which insurance and other approvable techniques can be used to reduce the capital requirement;
- e) the internal validation process (including any third parties that have participated or participate in the assessment of the model);
- f) the use of the AMA Approach within the everyday process of operational risk management;
- g) the method for the continuing (ongoing) assessment of the appropriateness of the model and its outputs, including independent audits focusing on the internal model for managing and measuring operational risk.

If relevant, the general part shall also contain an assessment of:

- h) the comparability of data and methodologies in the management of operational risk in the group;
- i) the interconnectedness of the information systems in the management of operational risk in the group;
- j) the mutual compatibility of the information technologies in the management of operational risk in the group.

The specific part of the self-assessment shall contain a judgment of to what extent all of the requirements for the AMA Approach defined by the Decree are satisfied. Data on identified shortcomings and errors and a plan for their elimination and achieving compliance with the requirements defined by the Decree shall form an integral part of the self-assessment.

15. A list of all the relevant external documentation and internal documents that are available at the liable entity (upon request) and that relate to the management and measurement system for the risk to which the liable entity wishes to apply the special approach.

#### **IV. In the case of an advanced approach to operational risk measurement combined with other approaches (the AMA Approach combined with the BIA Approach, the Standardised Approach or the ASA Approach):**

16. The particulars specified for the advanced AMA Approach pursuant to Section III above.

17. A description of the manner in which the individual approaches for calculating the capital requirement to cover operational risk are combined, including the manner in which the overall coverage of operational risk is achieved by combining more approaches than one (e.g. coverage of various geographical areas, legal entities or other internally defined areas by the individual approaches).
18. Documents demonstrating that the liable entity satisfies the requirements for operational risk management stipulated by the Decree (structured according to the approaches used); i.e., documents demonstrating compliance with the requirements for the use of:
  - a) the AMA Approach in the case of activities with the AMA Approach;
  - b) the Standardised Approach in the case of activities with the Standardised Approach;
  - c) the ASA Approach in the case of activities with the ASA Approach.

**V. In the case of the Alternative Standardised Approach (ASA Approach):**

19. Documents demonstrating that:
  - a) an overwhelming majority of the liable entity's activities falls under the retail banking business line or commercial banking business line; this requirement shall be deemed met, if the net interest and dividend incomes from these activities account for at least 90 % of the relevant indicator calculated under the Basic Indicator Approach (BIA Approach). For the purposes of this calculation, the definition of business lines and the calculation of the relevant indicator shall be the definition as given in the Decree;
  - b) a significant part of the liable entity's activities in the field of retail or commercial banking is composed of exposures that are associated with a high probability of default;
  - c) the ASA Approach constitutes an improved basis for operational risk evaluation; the liable entity shall comply with the requirements for operational risk management stipulated by the Decree; i.e., documents demonstrating:
    1. compliance with the generally applicable requirements for operational risk management;
    2. compliance with the requirements for operational risk management specified for the ASA Approach.
20. A list of all the relevant external documentation and internal documents that are available at the liable entity (upon request) and that relate to the operational risk management and measurement system to which the liable entity wishes to apply the special approach.

**VI. In the case of the Standardised Approach combined with the Basic Indicator Approach (the Standardised Approach in combination with the BIA Approach), the documentation supplied together with the application for a transitional use of the Standardised Approach combined with the BIA Approach shall include:**

21. Documents demonstrating that:
  - a) an exceptional event has occurred (e.g. an acquisition of an ownership interest in some other entity that uses a different approach to determining the capital requirements to cover operational risk);
  - b) the exceptional event requires the BIA Approach and the Standardised Approach to be used concurrently for a transitional period.
22. A timetable for the roll-out of the Standardised Approach (so-called "roll-out plan").

23. A declaration by the liable entity to the effect that:
- a) it meets the generally applicable criteria for operational risk management stipulated by the Decree;
  - b) the preconditions are in place to ensure that the requirements for the use of the Standardised Approach, as specified in the Decree, will be satisfied no later than on the day on which the Standardised Approach roll-out process pursuant to paragraph 22 above is completed.

24. The liable entity's commitment:
- a) to comply with the roll-out plan pursuant to paragraph 22 above;
  - b) to comply with the requirements for the use of the Standardised Approach pursuant to paragraph 23 (b) above within the specified time limit.

25. A list of all the relevant external documentation and internal documents that are available at the liable entity (upon request) and that relate to the management and measurement system for the risk to which the liable entity wishes to apply the special approach.

**VII. In the case of the Alternative Standardised Approach combined with the Basic Indicator Approach (the ASA Approach in combination with the BIA Approach), the documentation supplied together with the application for a transitional use of the ASA Approach combined with the BIA Approach shall include:**

26. Documents demonstrating that:
- a) an exceptional event has occurred (e.g. an acquisition of an ownership interest in some other entity that uses a different approach to determining the capital requirements to cover operational risk);
  - b) the exceptional event requires the BIA Approach and the ASA Approach to be used concurrently for a transitional period.

27. Information as to whether, after such an exceptional event has occurred, the liable entity will be able to comply with the requirements for the use of the ASA Approach as specified by the Decree, or whether, as a consequence of such an exceptional event, it will no longer be able to comply with the requirements for the use of the ASA Approach and will implement the Standardised Approach.

28. A timetable for the roll-out of the ASA Approach (so-called "roll-out plan") or a timetable for the implementation of the Standardised Approach (depending on the circumstances described in paragraph 27 above).

29. A declaration by the liable entity to the effect that:
- a) it meets the generally applicable criteria for operational risk management stipulated by the Decree;
  - b) the preconditions are in place to ensure that the requirements for the use of the ASA Approach or Standardised Approach, as specified in the Decree, will be satisfied no later than on the day on which the ASA Approach roll-out process is completed or on which the Standardised Approach is implemented (depending on the circumstances described in paragraph 27 above).

30. The liable entity's commitment:

- a) to comply with the roll-out plan pursuant to paragraph 28 above;
- b) to comply with the criteria for the use of the ASA Approach or Standardised Approach within the specified time limit pursuant to paragraph 28 above.

31. A list of all the relevant external documentation and internal documents that are available at the liable entity (upon request) and that relate to the operational risk management and measurement system to which the liable entity wishes to apply the special approach.

### **VIII. Final Provisions**

32. The Official Information of the Czech National Bank of 18 July 2007 regarding the prudential rules for banks, credit unions and investment firms – Application for prior approval for the use of a special approach (published in the Bulletin of the Czech National Bank under number 19/2007) is hereby repealed.

33. This Official Information shall be followed from 31 December 2010.

Vice-Governor:

prof. PhDr. Ing. Vladimír Tomšík, Ph.D., signed

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