



Prudential Practice Guide

APG 114 – Standardised Approach to Operational Risk

January 2008

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About this guide

Prudential Standard APS 114 Capital Adequacy: Standardised Approach to Operational Risk (APS 114) sets out APRA's requirements of authorised deposit-taking institutions (ADIs) in relation to the measurement of operational risk for regulatory capital purposes. This prudential practice guide aims to assist ADIs in complying with those requirements and, more generally, to outline prudent practices in relation to the management and measurement of operational risk.

Not all the practices outlined in this prudential practice guide will be relevant for every ADI and some aspects may vary depending upon the size, complexity and risk profile of the ADI.

Adjusted gross income

1. APS 114 requires operational risk regulatory capital as calculated by adjusted gross income for the 'all other activity' area of business. APRA envisages that, as good practice, examples of income items that would typically be excluded from adjusted gross income include:
 - (a) net interest income from total gross outstanding loans and advances and securities included in the retail and commercial banking areas of business;
 - (b) fee income from automated teller machine networks;
 - (c) fee income from retail and commercial transaction accounts;
 - (d) fee income from other payment facilities that map to retail and commercial banking such as EFTPOS;
 - (e) fee income from total gross outstanding loans and advances included in the retail banking and commercial banking areas of business (e.g. loan establishment fees, administration fees and penalty fees);
 - (f) income from insurance recoveries;
 - (g) realised profit or losses from the sale of banking book items;
 - (h) dividends; and
 - (i) other irregular items.

Good practice is that the price an ADI charges a subsidiary for services rendered adequately reflects the risks incurred by the ADI, including operational risk.



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