ECB-PUBLIC

EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Targeted Review of Internal Models (TRIM)

Media briefing conference call

Frankfurt, 28 February 2017

Overview of topics to be covered/not covered in this call

- **General update on TRIM project** as SSM Supervisory Priority for 2017
- Update on **Status quo** and immediate **next steps**
- Introduction to objectives and content of **Guide to TRIM**

- **Discussion** of individual **bank specifics**

Making Pillar 1 models more credible and assuring they are used appropriately

Initial implementation of Basel 2

Pillar I internal risk models introduced to encourage financial institutions to

- improve their understanding of the risks to which they were exposed
- better align the required regulatory capital with the internal assessment of these risks

Criticism since the financial crisis

- Increased criticism of the internal models
- Observed limitations of models
- Heterogeneous methodologies
- High complexity

- Same risks not modelled in the same way
- Different supervisory practices in each jurisdiction leading to different risk assessments from banks

Public stance towards internal models has deteriorated significantly

Internal Models Mightn't Be That Good at Measuring Bank Risk After All

"…a regulation that is based on banks' internal risk models may suffer from both informational and incentive problems. The authors also found that even though the use of internal modelling allowed banks to enjoy lower capital charges set by supervisors, on account of supposedly better risk measurement, the same institutions actually charged customers more for credit"

Bloomberg, July 4, 2016

https://www.bloomberg.com/news/articles/2016-07-04/banks-risk-models-understated-loan-defaults-ecb-paper-shows

Market frets as Basel turns up heat on risk weights

"…After spending much of the time since 2008 tweaking minimum capital levels, the rule-setting body has turned its focus over the last two years towards the internal capital calculations that banks use to determine their individual needs."

Reuters 3 June 2015

http://www.reuters.com/article/banks-capital-idUSL5N0Y42TF20150603

Banks Face Basel Clampdown on Risk-Model Variation

"…"There is an active debate around the extent to which banks should use internal models for regulatory purposes but the committee's position is that there must be both a leverage ratio along with a risk-weighted approach -– the belt-and-braces approach," Coen said. "Banks can arbitrage one, but you can't game both."

Bloomberg, October 9, 2014

https://www.bloomberg.com/news/articles/2014-10-09/banks-face-basel-clampdown-on-risk-model-variation

The future of the IRB approach

…a lack of trust regarding the use of internal models: i) High flexibility embedded in the IRB framework […]; ii) Concern that models are used to ensure low capital requirements, i.e. regulatory arbitrage, by some institutions; iii) Supervisory practices are divergent

EBA (March 2015). The future of the IRB approach

https://www.eba.europa.eu/documents/10180/1003460/EBA-DP-2015-01+DP+on+the+future+of+IRB+approach.pdf

TRIM initiated to address this criticism !

Way defined to achieve the overall objective of TRIM

Ensure compliance with regulatory standards

Verify compliance of internal rating systems and models with regulatory requirements

Harmonise supervisory practices in the SSM

Define and communicate harmonised principles and rules reducing modelling freedom [Guide for the TRIM]

Reduce non-risk-based (unwarranted) RWA variability

Assess compliance with principles and rules laid out in the guide for the TRIM to reduce unwarranted RWA variability

Confirm adequate capital requirements

Verify adequacy of calculated capital requirements based on internal models

To **enhance credibility and confirm adequacy and appropriateness** of approved Pillar I internal models used by SIs in the SSM

TRIM covers all Significant Institutions with Internal Models in the SSM

Risk types

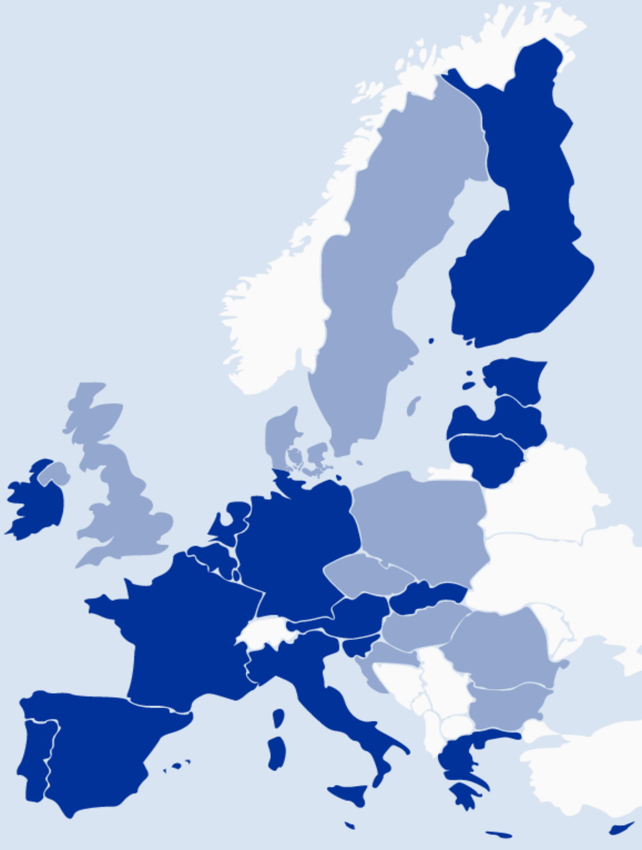
- **Credit** Risk (CR)[1], **Market** Risk (MR) and **Counterparty Credit** Risk (CCR) models included
- **Operational Risk out of scope** due to the forthcoming regulatory changes for the Advanced Modelling Approaches

Banks

- **All Significant Institutions** with approved Pillar 1 internal models in scope
- Missions at **68 banks within 15 countries**

Coverage

- **At least 60% of the IRB EAD for Credit Risk** covered [equals EUR ~7 trillion]
- **All internal models** on **Market Risk**[2]
- **All internal models** on **Counterparty Credit Risk**[3]



1 For CR, Retail and SME portfolios are the focus of 2017
2 Only CRM excluded
3 Only CVA excluded

TRIM project defines an appropriate answer to restore public trust in internal models

*… more than **100 TRIM investigations led by SSM staff** in **2017** which sums up to **more than 9000 person weeks on-site** and TRIM will last at least **until the end of 2018**…*

*… more than **500 people** will be involved in the execution phase composed of SSM staff and external consultants…*

*…**~15% of total SSM budget** will be invested in TRIM only in 2017 – the **biggest single project investment** of the entire ECB Banking Supervision history…*

*…currently, **more than 300 on-site colleagues will be trained** within the ECB…*

*…close to **100 people are now involved in the project organisation at the ECB** and the **national competent authorities***

Guide to TRIM on General Topics, Credit Risk, Market Risk and Counterparty Credit Risk

- **150 pages**
- 4 chapters dedicated to **General topics**, **Credit risk**, M**arket risk**, **Counterparty credit risk**

The guide…

- …sets out the **ECB's view on how the relevant EU law should be applied in targeted areas**
- …is **rooted within EBA's views** and will be a **contribution to EBA's internal model repair strategy**
- …entails **harmonised standards** addressing current **interpretational freedom and gaps** in the regulation, ensuring close alignment with upcoming changes
- …ensures a level playing **field across SIs** as on-site teams are requested to strictly apply the guide

Guide available on the ECB banking supervision website after this call!

High-level roadmap for TRIM: On-site activities are now starting in full

Preparation Phase

2016 – Beginning of 2017

- **Institution specific reviews** on model governance
- **Model prioritisation** and **selection of Models**
- Definition of **methodology** and **inspections tools & techniques**
- **Planning & preparation**
- **Field-tests**
- **Training programme**

Execution Phase

April 2017 – End of 2018/Beginning 2019

- **Model-specific reviews** on-site (TRIMIs and TRIMIX)
- **Data quality** review
- **Consistency checks** and **peer reviews**
- **Supervisory measures** and **decisions** as part of follow-up process

- **Refinement of guide** based on **public consultation**

DISCLAIMER

This presentation was developed based on the knowledge available at the point in time, when the content for this presentation was developed. Changes might apply in the future.