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

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

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

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)**, **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**
- **All internal models on Counterparty Credit Risk**

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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

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!

- 150 pages
- 4 chapters dedicated to General topics, Credit risk, Market risk, Counterparty credit risk
**High-level roadmap for TRIM: On-site activities are now starting in full**

<table>
<thead>
<tr>
<th>Preparation Phase</th>
<th>Execution Phase</th>
<th>Refinement of guide based on public consultation</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Institution specific reviews on model governance</td>
<td>• Model-specific reviews on-site (TRIMIs and TRIMIX)</td>
<td></td>
</tr>
<tr>
<td>• Model prioritisation and selection of Models</td>
<td>• Data quality review</td>
<td></td>
</tr>
<tr>
<td>• Definition of methodology and inspections tools &amp; techniques</td>
<td>• Consistency checks and peer reviews</td>
<td></td>
</tr>
<tr>
<td>• Planning &amp; preparation</td>
<td>• Supervisory measures and decisions as part of follow-up process</td>
<td></td>
</tr>
<tr>
<td>• Field-tests</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Training programme</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
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