EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Agenda – on-site pre-application meeting
INSTITUTION NAME
Address (including city)
DATE, start time / finish time

The ECB would like to discuss with INSTITUTION NAME the pre-application process and the main components of the initial model approval/material model change that the institution is planning to request.

Day, date

Pre-application process for **initial model approval / material model change request for the TBD portfolio**	

	I. PART 1 (led by the ECB)
	
	Overview of the pre-application process
	
	II. PART 2 (led by INSTITUTION NAME)[1]
	
	1. Portfolio analysis: portfolio description, scope of the application, impact on own funds requirements
	
	2. Organisational structure and governance
	[Coffee break]
	
	3. Overview of the following processes:
	   ➢ Definition of loss and default
	   ➢ Rating assignment process
	   ➢ Assignment of exposures to exposure classes
	   ➢ IT infrastructure
	   ➢ Data quality process
	   ➢ Internal documentation
	
	[Lunch break]
	
	4. Model description: model inputs, structure of the rating system, risk parameter quantification
	
	5. Model use: internal use of the risk measurement system, use test, experience test, internal reporting, calculation of own funds requirements, stress testing
	[Coffee break]
	
	6. Validation: framework and results
	
	7. Internal audit
	
	III. CLOSING REMARKS

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[1] The institution is requested to prepare clear and informative presentations for all the items listed. The Annex contains a more detailed explanation of the topics covered. The presentations should be sent to the ECB, together with the pre-application package, approximately 1-2 weeks before the pre-application meeting.

ANNEX TO THE PRE-APPLICATION MEETING AGENDA

This annex provides **guidance on the ECB's minimum expectations** for each topic presented.

The institution is **requested to extend the scope** of the presentations and to include additional relevant items that are deemed crucial specifically for that **institution**. In this regard, the institution should **focus on already identified model weaknesses or deficiencies, along with the remediation actions envisaged**.

The presentations should be self-contained and clear, focusing only on relevant information. The supporting documentation should not include more than 20 slides for a one-hour presentation.

The timing can be adjusted to reflect the relevance of each topic; additional items can be added at the request of the competent authorities.

1. Portfolio analysis

1.1. Portfolio description

Provide a summary and the essential details of the application portfolio and its relation to the institution's overall portfolio. This includes, for example, an overview of the average values of risk parameters and an overview of risk-weighted assets (RWA) and exposure, compared with the institution's aggregate values. The presentation may also contain descriptive statistics on the distribution of obligors and a breakdown of the portfolio by key driver (exposure, rating/risk grades etc.). Provide a summary and the essential details of the recent development of the portfolio and expected potential changes/shifts resulting from the implementation of a new business decision made by the institution, for instance (if applicable).

1.2. Scope of the application

Provide a summary and the essential details of coverage in terms of legal entities and an analysis of permanent partial use and roll-out plans, if applicable to the portfolio concerned.

1.3. Impact on own funds requirement

In the case of initial approval, provide a summary and the essential details of the impact of using the internal ratings-based (IRB) approach as opposed to the standardised approach. In the case of a model change or extension indicate the impact of the change or extension. Impacts should be shown for exposure at default (EAD), RWA, expected loss (EL) and capital adequacy ratios.

2. Organisational structure and governance

2.1. Organisational structure

Provide a summary and the essential details of the organisational structure, showing the most relevant information, such as organisation charts, an overview of the relevant roles of the departments involved, the hierarchy, reporting lines, levels of responsibility and any other relevant information.

2.2. Governance

Provide a summary and the essential details of the most relevant policies and processes related to the initial model approval or model changes covered by the pre-application (e.g. the model development/changes and the model validation process). Provide a summary and the essential details of the operation of the credit risk control unit and internal reporting.

3. Processes

3.1. Definition of loss and default

Provide a summary and the essential details of the institution's internal policies and procedures for the application of the definition of default, the treatment of defaulted exposures and the definition of loss. This may include an explanation of (i) the triggers used to identify default, (ii) the robustness and effectiveness of the process, and (iii) the triggers and processes used by the institution when reclassifying a defaulting obligor to non-default status. Provide a summary and the essential details of materiality thresholds, the definition of technical default and contagion criteria.

3.2. Rating assignment process

Provide a summary and the essential details of the adequacy of the definitions, processes and criteria used by the institution to perform or review the assignment of exposures to grades or pools. Provide a summary and the essential details of the internal policies that ensure the independence of this process from the origination or the renewal of exposures. In addition, describe the override process and provide relevant statistics.

3.3. Assignment of exposures to exposure classes

Provide a summary and the essential details of the institution's assignment methodology for assigning exposure to exposure classes and its implementation, the sequence of the processes and specific considerations with regard to the retail exposure classes. Provide a summary and the essential details of the process for managing migration from exposure classes, if relevant.

3.4. IT infrastructure

Provide a summary and the essential details of the IT infrastructure, including a data flow diagram showing the relevant information regarding the IT system architecture, a map of the key applications, databases, IT components involved in the application of the IRB approach, and information regarding the completeness of relevant data used for estimating risk parameters.

3.5. Data quality process

Provide a summary and the essential details of the mechanisms and procedures the institution has implemented to identify all the data related to risk parameters and credit risk mitigation techniques. Provide a summary and the essential details of the institution's processes/areas dedicated to ensuring data quality (consistency, accuracy, etc.) and how these processes can ensure proper data collection and storage.

3.6. Internal documentation

Provide a summary and the essential details of the documentation management approach for the topics covered by this agenda (e.g. the triggers and frequency for the documentation updates, the owners of the documents, the staff involved in documentation management and the bodies responsible for approvals).

4. Model description

4.1. Model inputs

Provide a summary and the essential details of the inputs used for the estimating the probability of default (PD), loss given default (LGD) and credit conversation factor (CCF). A part dedicated to credit risk mitigation techniques (CRMT) could be added to the LGD section, for example. Provide a summary and the essential details that prove that the data used for the estimation are representative of the institution's current exposures and lending standards.

4.2. Structure of the rating system

Provide a summary and the essential details of the methodology used to build homogeneous and risk-differentiated pools and grades, including internal policies and human judgement decisions. The presentation may also explain the point-in-time as opposed to the through-the-cycle nature of the rating system covered by the pre-application.

4.3. Risk parameter quantification

Provide a summary and the essential details of the methodology used to estimate each risk parameter concerned, paying special attention to the following topics: time horizon, empirical/historical experience, drivers/rating criteria used, weights, economic factors taken into account, robust explanation/justification of assumptions made about the model, definition of a complete economic cycle (PD), collateral classification/valuation (LGD), downturn adjustment, CRMT (LGD) estimation of parameters for defaulted assets and margin of conservatism, etc.

5. Model use

5.1. Internal use of the risk measurement system

Provide a summary and the essential details of the use of the internal model in the relevant processes; in risk management, for example, in the decision-making process, in the approval process, pricing, credit risk adjustments calculation and limit setting in the credit approval process.

5.1.1. Use test

Provide a summary and the essential details demonstrating that internal ratings, default and loss estimates of the rating systems used in the calculation of own funds play an essential role in the following areas:

- the risk management, credit approval and decision-making processes
- the internal capital allocation process
- the corporate governance functions.

5.1.2. Experience test

Provide a summary and the essential details demonstrating that the internal ratings and risk estimates from the rating systems have been used for at least the last three years in the internal risk measurement and management processes and that adequate documentation is available to support this.

5.2. Internal reporting

Provide a summary and the essential details of the form, frequency, content and recipients of the institution's internal reporting, paying special attention to the reconciliation of the risk parameters used for internal reporting and the calculation of own funds requirements.

5.3. Calculation of own funds requirements

Provide a summary and the essential details of the institution's internal policies and procedures for the own funds requirements calculation process, such as sources of data, calculation methods, controls applied, and the roles and responsibilities of the different units and internal bodies involved in the process.

5.4. Stress testing

Provide a summary and the essential details of the methods used to design the stress tests and the integration of the stress tests in the risk and capital management processes. A description of the role of the stress test in the decision-making process may also be included.

6. Validation

6.1. Validation framework

Provide a summary and the essential details of the process, methodology and documentation for the revision of the risk estimates and the review frequency.

6.2. Validation results

Provide a summary and the essential details of the results of the internal validation activities related to the model concerned, including the results of the tests, replications, conclusions, findings and relevant recommendations.

7. Internal audit

7.1. Internal audit

Provide a summary and the essential details of the final internal audit report results and recommendations, where appropriate. If this is not available or has not been completed by the time of the pre-application meeting, provide a summary and the essential details of the following items:

- the internal audit plan and process
- recommendations from the previous internal audit report (including the data quality review) and current status

However, the final internal audit report shall be made available to the supervisor before the pre-application process is finalised.