



EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Feedback statement

Responses to the public consultation on the draft ECB Guide on assessment methodology (EGAM) for the internal model method for calculating exposure to counterparty credit risk and the advanced method for own funds requirements for credit valuation adjustment risk

BANKENTOEZICHT

September 2020

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This document provides an overview of the comments received during the public consultation on the draft ECB Guide on assessment methodology (EGAM) for the internal model method (IMM) for calculating exposure to counterparty credit risk (CCR) and the advanced method for own funds requirements for credit valuation adjustment risk (A-CVA). Furthermore it provides an assessment of those comments and explains the amendments made to the EGAM as a result of the public consultation.

1 Introduction and overview of responses

1.1 Context

A first version of the ECB Guide on assessment methodology for the internal model method for calculating exposure to counterparty credit risk and the advanced method for own funds requirements for credit valuation adjustment risk (hereafter “EGAM”) was published on 15 December 2017 in order to collect first industry feedback by 31 March 2018. The ECB consequently made changes to the EGAM in response to a number of industry comments before launching the public consultation of the next EGAM version on 5 February 2020. This second version is the subject of the present feedback statement. The public consultation, which ended on 18 March 2020, was conducted in order to collect responses from relevant parties and to further enhance transparency.

The ECB has given due consideration to all of the comments received during the consultation period.

1.2 Structure of the feedback statement

This feedback statement presents an overall assessment of the comments received during the public consultation. Amendments to the EGAM have been made as a result of the comments received.

The remaining sections of this document summarise the key comments received on the different chapters of the EGAM and, where needed, the resulting amendments. However, it only lists the most relevant and frequent groups of comments and/or amendments. In several cases, further minor changes have been incorporated in the document to clarify certain aspects that were raised during the public consultation. Clarifications have also been included when the ECB has been made aware that further and more detailed alignments with the Capital Requirements Regulation (CRR)¹, the consolidated [ECB Guide to internal models](#)² (hereafter “EGIM”) and other guidelines would be helpful.

¹ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1), as amended by Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019.

² References to the EGIM, unless otherwise stated, refer to the chapter on counterparty credit risk.

1.3 Response statistics

In total, 18 submissions were received from two banks supervised by ECB Banking Supervision, including the comments listed below.³ These comments cover several parts of EGAM.

In addition, and for the sake of transparency, alignments with other guidelines (mostly EGIM) have been added in the assessment tables in Section 2 below.

1.4 Adoption of the EGAM

A complete draft proposal for the adoption of the EGAM was sent by the Supervisory Board to the Governing Council of the ECB on 03.09.2020. The guide, as adopted by the Governing Council on 11.09.2020, was published on the ECB's website on 18.09.2020, together with this feedback statement.

³ One additional bank submitted a comment on the process, without reference to the guide's content; therefore this is not included in the feedback statement.

2 Comments on and amendments to the draft EGAM chapters

The paragraph numbers in this chapter refer to the paragraph numbers in Chapter 4 of the EGAM, unless otherwise stated.

2.1 Foreword and general comments

	Comment	ECB response and analysis	Amendment
1	Further clarification of the relation between EGAM and other ECB guides, in particular the ECB Guide to internal models (EGIM), would be beneficial.	In its chapter on the CCR, the EGIM outlines how the ECB understands relevant CRR provisions for the IMM. This was clarified in the EGAM by adding the corresponding references in the introduction and at the beginning of Section 4, making clear that the focus of EGAM is instead to provide transparency on what is assessed in order to verify compliance with the existing legal framework for the IMM and A-CVA.	Amended
2	Wording alignments were proposed with the ECB Guide to options and discretions (EGOD) with regards to the sequential implementation and the M parameter relevance for A-IRB.	The wording of Section 3.2 (first paragraph) of the EGAM was aligned with EGOD wording, as in Section 2, Chapter 3, paragraph 9 regarding sequential implementation. Furthermore, regarding the M parameter, the wording of Section 3.7.4 (second paragraph) of the EGAM was aligned with EGOD wording, as in Section 2, Chapter 3, paragraph 5, where for F-IRB institutions only the first sub-paragraph of Article 162(2) of the CRR applies.	Amended
3	A clarification of EGAM in comparison with the CRR was proposed regarding the internal audit frequency and the reporting requirement of exposure time profile.	The wording was amended in paragraphs 16(4)(a) and 18(2)(a) in order to align it with the CRR wording, to include CRR references to Articles 288 and 293(1)(h) of the CRR and to clarify that the EGAM does not imply stricter requirements than those already laid down in the CRR.	Amended
4	It was highlighted that a reference to Article 284(1) of the CRR could be inserted in paragraph 27(1)(a).	Paragraph 27(1)(a) was amended to align the wording with the CRR and to include the mentioned CRR reference.	Amended
5	Clarification was sought regarding the scope of the convergence requirement in paragraph 35(1) in comparison with EGIM.	The wording was aligned with paragraph 51 of the EGIM, so that only the convergence of the effective expected positive exposure (EEPE requires a thorough check to verify that it is reasonable for the use test.	Amended

2.2 Organisation, governance and documentation

	Comment	ECB response and analysis	Amendment
1	Respondents requested the insertion of a further clarification for the assessment of the adequacy of the implementation of the CCR exposure model in IT systems, by specifying that it includes e.g. verifying test concepts.	Paragraph 11(2)(b) was amended to specify further the IT implementation adequacy. It includes challenging test concepts and processes.	Amended
2	Respondents suggested linking the verification of the criteria for the stability and adequacy of the calibrated parameters in documentation to the material ones, and asked on the documentation how to identify relevant parameters.	Paragraph 25(c)(ii) was amended by adding "material" and clarifying that it is applicable "at least for the material risk factors", because the number of risk factors can be very large. A new item was included referring to the identification and definition of relevant parameters.	Amended
3	Respondents asked for a clarification of "stochastic model" in paragraph 25, indicating that their interpretation was that the wording here refers to pricing models implemented in the pricing functions.	The interpretation of the respondents is correct. Paragraph 25(2)(i) was changed, replacing "stochastic" with "pricing". This clarification also affected paragraphs 25(2)(k) and 40, and triggered a further definition in paragraph 1(2)(n).	Amended
4	Respondents suggested removing from paragraph 25(2)(j)(ii) a part that would require an extensive documentation of market data conventions without adding proportional value.	The wording of the corresponding paragraph was refined by adding "case-wise" to ensure that relevant conventions would still be covered.	Amended

2.3 Pricing and calibration

	Comment	ECB response and analysis	Amendment
1	Clarification of paragraph 27(1)(d) was sought with regards to the interpretation of the M parameter in case of stressed versus current EE profiles.	The wording was adjusted to avoid potential misunderstandings regarding the alignment of EGAM with the other guides.	Amended
2	Respondents requested clarification in the context of price differences between the IMM and a benchmark regarding the treatment of transactions through carve-out in paragraph 32(3)(c) or through monitoring, exposure correction and remediation in paragraph 32(3)(d).	The wording was amended and aligned with EGIM paragraph 13(b) regarding measures other than carve-out.	Amended
3	It was suggested to align EGAM paragraphs 32 and 37 with EGIM wording regarding adjustments of price differences, the alternative exposure calculation and their monitoring.	The wording was aligned with EGIM paragraphs 16 and 17.	Amended
4	Respondents proposed deleting the CRR reference in paragraph 37(3)(c), because Article 289(5) of the CRR would not explicitly require the modelling of cash-flows in the margin period of risk (MPOR).	The wording was aligned with EGIM without changing the content in order to clarify that Article 289(5) of the CRR itself is not directly referring to the cash-flows in the MPOR, but that this covers also cash-flows in margined trading.	Amended
5	Respondents proposed replacing the expression "conservative manner" in paragraph 38(1) on the inclusion of legal attributes in the modelling with the respective EGIM wording which refers to "not systematically lead to an underestimation of exposure".	The wording was aligned to the general requirement of no systematic exposure underestimation of the EGIM glossary.	Amended
6	It was suggested to align the calibration frequency with the EGIM.	Paragraph 41(2) was aligned with EGIM paragraph 55. In addition, sub-paragraph (2)(b) was deleted for clarity, as the EGAM is not meant to introduce any new requirements or expectations in comparison with the CRR and EGIM.	Amended

2.4 Margin period of risk and collateral modelling

	Comment	ECB response and analysis	Amendment
1	Additional CRR references on the length of the MPOR have been suggested, for clarification in paragraph 43(1) and (4)(c).	Paragraph 43 was amended to add CRR references: Articles 285(2) to (5) and 285 (2) and (3).	Amended
2	Respondents suggested explicitly adding the possibility for banks to show immateriality of spikes within MPOR.	Paragraph 44 was amended to align the wording with paragraph 20(e) of the EGIM regarding the materiality of cash-flows in line with the DMP.	Amended
3	It was suggested to align paragraph 46(6) with the EGIM regarding the modelling of securities, because the EGIM refers only to an example and best practice.	The wording of paragraph 46(6) was aligned with EGIM paragraph 26, and the former sub-paragraph (6)(b) was shifted into a footnote as referring only to an example.	Amended
4	Respondents suggested removing condition (ii) from paragraph 46(6)(c) to allow, in line with the EGIM, for simulating collateral for securities financing transactions (SFTs) and applying haircuts for OTC regardless of materiality.	The former item (ii) of paragraph 46(6)(c) was deleted, as it overlaps with the requirement of not systematically underestimating exposure.	Amended
5	Respondents requested an amendment of paragraph 47(3)(e) on initial margin in order to leave room for close or similar ISDA SIMM modelling without identical implementation.	The example (former item 47(3)(d)) was moved into (b) and extended by including the second possible option, which is to model the general dynamics of IM and not the details of ISDA SIMM, which is expected to meet the institutions' comment.	Amended
6	Respondents sought clarification that intermediate SFT cash-flows should only be incorporated in the simulation if they are not immaterial.	Paragraph 48(1)(c) was amended to reflect this immateriality condition.	Amended

2.5 Validation

	Comment	ECB response and analysis	Amendment
1	Clarification regarding the role of validation mentioned in sub-paragraph 2 of Section 3.3 was suggested.	The corresponding sub-paragraph was amended to clarify the independence of model validation from model development and a CRR reference to Article 293(1)(c) was added.	Amended
2	Clarification of paragraph 4(3), dealing with the involvement of third parties in initial and ongoing validation activities, was suggested.	Paragraph 4(3) was amended in order to further clarify some cases, removing overlaps and referencing the EGIM General topics paragraph 123, footnote 103, and the new EBA guidelines for outsourcing.	Amended
3	Respondents requested that "ensures" be replaced with "verifies" in paragraph 11(2)(c).	Paragraph 11(2)(c) was amended: "ensures" was replaced with "challenges", because ensuring the model performance is not a validation task.	Amended
4	A wording alignment of paragraph 11(3) to the ECB Guide on materiality assessment (EGMA) was proposed with regards to the materiality classifications and to the readiness of validation in the event of model changes and extensions.	Paragraph 11(3) was amended and "material" was replaced with "to be investigated, e.g. material ones" in line with the EGMA wording. In addition, the readiness of validation was further clarified in accordance with Chapter 5, Section 8, paragraph 1(e) of the EGMA.	Amended
5	Respondents requested that the definition of the remedial actions be unlinked from the actual validation report, which may raise issues.	Paragraph 13(4)(b) was amended to clarify that this plan would be required after the validation report was issued, at the latest.	Amended
6	The alignment of the wording of paragraph 52(1)(a)(ii) with EGIM wording was proposed in order to distinguish good practices from mandatory requirements regarding back-testing levels.	The wording of paragraph 52(1) was aligned to EGIM paragraph 63. The reference to SFTs in 52(1)(a)(ii) EGAM has been deleted. In addition, the beginning of paragraph 52(1) has been changed to "ECB assesses if" instead of "ECB verifies that" to reflect that it concerns good practice.	Amended
7	Respondents highlighted that expectations in paragraph 54(2)(b) regarding comparison of the simulated long-term behaviour of market data using historical charts may not allow statistically significant conclusions.	The item on assessing the quality of risk measures beyond the one-year time horizon has been shifted to paragraph 56 in order to clarify that the topic is not necessarily back-testing related, i.e. other quantitative validation methodologies may be used. In addition, it is assumed that important market data should be available for a long-time horizon and therefore this is not expected to result in issues with statistical insignificance.	Amended
8	Respondents highlighted that benchmarking both the collateral balance and the IM, as modelled in the IMM, is not necessary if at grid point t0 an institution uses the actual collateral balance.	This understanding is correct. Paragraph 56(3) has been slightly amended to reflect this.	Amended

2.6 Stress testing, IMM use test and A-CVA

	Comment	ECB response and analysis	Amendment
1	It was proposed to clarify which IMM exposure measure should be taken into account for the use test.	Paragraph 20(1)(a) was amended to clarify that the EEPE is not necessarily meant, but use test exposures should be based on the IMM distributions, as required by Article 284(1) of the CRR.	Amended
2	For paragraph 23(1)(a), clarification was proposed regarding the use test requirements for initial IMM approvals and to-be-investigated model extensions. Furthermore, it was proposed to delete the footnote on model changes.	The corresponding paragraph has been amended to clarify use test requirements for initial IMM approvals and to-be-investigated model extensions. In addition, the footnote was deleted to avoid backlogs of model changes. Sub-paragraph 2 has been deleted because of the overlap with 1(a).	Amended
3	Respondents sought clarification of paragraph 66(1)(c) regarding the meaning of the sentence "the composition of their underlying CDS baskets (or single name proxies) is stable over time" and mentioned that the application of this requirement is difficult in some cases. In addition, they requested the clarification of "single proxies" in the same sentence.	The paragraph was amended to clarify that the stability expectation does not apply in absolute terms and that samples are also included in the stability requirement.	Amended
4	Respondents requested the deletion of sub-paragraph 66(1)(f)(i) regarding the basis risk between counterparties that are mapped (i.e. proxied) to the same bucket and highlighted that there would always be more than one counterparty per bucket.	The sub-paragraph was deleted in order to take into account data constraints, and sub-paragraph (ii) was merged with the text one level higher to become directly part of (f).	Amended

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Postal address 60640 Frankfurt am Main, Germany
Telephone +49 69 1344 0
Website www.bankingsupervision.europa.eu

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For specific terminology please refer to the [SSM glossary](#) (available in English only).