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EBF response to ECB consultation: guide on materiality assessment (EGMA) for changes to counterparty credit risk models

Key points:

- ◆ We welcome the ECB's draft Guidance on the Materiality Assessment (EGMA) for IMM and A-CVA model extensions and changes.
- ◆ We think that the requests for model changes/extensions should be supported by rigorous analyses proving their need, but the regulation should not hinder the industry in the enhancement of the models. Excessive approval constraints discourage investment in the development of new risk management tools or, even worse, lead to a divergence between regulatory and internal risk measurement.
- ◆ It is our understanding that several different extensions or changes of the same materiality may be merged into one change regarding the quantitative impact assessment. This would considerably reduce complexity and allow implementation without delays. We seek clarification if this understanding is correct.
- ◆ Finally, we seek clarification that any adjustments to IRB parameter that result in a change in RWA for CCR are excluded from the requirements in the EGMA paper.

EBF position:

General comments

We welcome the ECB's draft Guidance on the Materiality Assessment (EGMA) for IMM and A-CVA model extensions and changes. No RTS have been mandated in the CRR for material model extensions and changes to the internal model method (IMM) and advanced CVA (A-CVA). Therefore, ECB guidelines will help us to know and understand how the ECB intends to handle these model extensions and changes.

We think that the requests for model changes/extensions should be supported by rigorous analyses proving their need, but the regulation should not hinder the industry in the enhancement of the models. Excessive constraints on the approval of model changes may discourage investment in the development of new risk management tools or, even worse, lead

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to a divergence between regulatory and internal risk measurement. This would remove the benefits of the use test, which is the first assurance of the soundness of adopted solutions.

We appreciate that feedback from the industry to an earlier version of the EGMA paper has been taken into account when drafting in the consultation paper. Still, there are further topics that should be considered.

Specific comments

1. Timing issues

Section 2, 2. states that "Prior to implementing the extension or change, the institution waits for the ECB". It is understood that banks should address model changes that require an investigation as early as possible and provide the documentation listed in EGMA. We would like to stress the importance for the change process to receive at the earliest possible time feedbacks from the supervisors and their assessment of change.

2. Quantitative thresholds

It should be made more explicit that "overall risk-weighted exposure amounts for the CCR" as referred to in Section 4(1)(c) includes counterparty credit RWA calculated with an internal model method approach or a standardised approach. Hence the numerator of the ratio would be the "impact of the extension or change to the IMM model" as stated in Section 4(5) and in the denominator the overall RWA for counterparty credit risk, i.e. for both derivatives and SFTs and for both those calculated with an internal model method approach or a standardised approach. In this respect the reference in the parenthesis of Section 4 (1)(c)(i) is misleading as it only make reference to Part Three, Title II, Chapter 6 while some counterparty credit risk exposures may be calculated according to Part Three, Title II, Chapter 4 (typically SFTs).

3. Principles governing the classification of extensions and changes

Section 3, paragraph 4 is understood to mean that several changes of little materiality (much below the day-1 assessment 1% threshold) as well as larger changes as long as their anticipated impact are not offsetting one another may be merged into one change regarding the quantitative impact assessment. This would considerably reduce complexity for measuring the quantitative impact and enable banks to implement necessary changes of low materiality without delays. We seek clarity if this understanding is correct.

4. Out of scope business-as-usual changes

The IMA RTS (Commission delegated regulation (EU) 2015/942¹) makes it clear in recital-7 that minor changes for the ongoing alignment of models to the calculation of the data-set used or for the day-to-day maintenance of the model are out of scope². We would appreciate that this clarification is also present in the EGMA.

5. CCR RWA changes due to IRB parameter adjustments

A change in CCR RWA may be caused by adjustments to parameters outside the scope of IMM, such as those which enter at the Risk Weight formula of CRR Art. 153: LGD, PD and M. The EGMA paper should make clear that any adjustments to these or similar parameters that result

¹ <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R0942&from=EN>

² "The permission of competent authorities relates to the methods, processes, controls, data collection and IT systems of the approaches, therefore ongoing alignment of the models to the calculation data-set used, correction of errors or minor adjustments necessary for the day-to-day maintenance of the internal approaches, which occur in the strict limit of the already approved methods, processes, controls, data collection and IT systems, should not be covered by this Regulation."

in a change in RWA for CCR but are not part of IMM are excluded from the requirements in the EGMA paper.

6. A-CVA materiality assessment related to changes to IMM or IMA

We would like to seek confirmation that for changes of IMM or IMA impacting A-CVA VaR and stressed VaR the EGMA is expecting that:

- an impact assessment on regulatory CVA shall be performed
- considering that such changes shall be considered as requiring ex-post notification only [EGMA Section 1(d)], the impact assessment may be calculated on a single date even though the materiality threshold of 1% is exceeded (since according to EGMA Section 6 Footnote 11, Section 6 only applies to non-IMM and non-IMA related changes) .

We would like to stress that such assessment will lead to additional burdens for banks in their release of changes and we are of the opinion that such impact assessment is not warranted. If for instance EEPE is changing due to an IMM methodology change, on the A-CVA side it appears as a pure position change, not as a methodology change. As a consequence, unless some specific assumption is made about how the hedges would be rebalanced after the change, the raw A-CVA impact figures would not bear information over the appropriateness and prudence of the methodology. If the ECB insists on some impact assessment, it is our view that they should be restricted to IMM changes deemed material and IMA changes related to specific risk associated with traded debt positions deemed material.

7. Criteria for A-CVA changes

According to our understanding, Section 1.3(c)(iii)(3rd bullet) refers to changes in the methodology of stress period selection. This should be clarified by adjusting the text to the following: "... stress period selection [methodology] in accordance...".

8. Extensions that need to be investigated

- Annex I, Part I, Section 1, 2: This should be clarified to exempt cases where the absence of market data no longer allows processing of trades within the IMM.
- Annex I, Part II, Section 1, 3: Reword "institution's judgment of" to "the way in which an institution judges" which will delineate between the possibility that a change only currently vs likely could in the future result in such a change in judgment.

9. Other topics

Section 2.2(e)(1st bullet): typo with an extra "the case", which needs to be removed

About EBF

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