EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Template for comments

Public consultation on the revised ECB guide to internal models

Institution/Company

European Savings and Retail Banking Group (ESBG)

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General comments

Template for comments

Public consultation on the revised ECB guide to internal models

Please enter all your feedback in this list.
When entering feedback, please make sure that:
- **each comment deals with a single issue only;**
- **you indicate the relevant chapter/section/paragraph, where appropriate**
- **you indicate whether your comment is a proposed amendment, clarification or deletion.**

Deadline:	15 September 2023

ID	Chapter	Section	Paragraph	Page	Type of comment	Detailed comment	Concise statement as to why your comment should be incorporated	Name of commenter	Institution	Personal data
1	General topics	1.2 Guidelines at consolidated and subsidiary levels	2 - footnote 6	6	Clarification	"In the case of credit risk, "internal models" should be read hereinafter as "IRB rating systems"" : Reference to models or rating system should be made in the text of the paragraphs and not in a footnote which creates confusion.	Both in the General Topics section and in the Credit Risk section, "internal models" and "rating system" are mentioned. Should we therefore understand that the distinction has already been made or should we interpret model as "rating system"? If the distinction has been made, we request that the footnote be removed or that it be clarified in each paragraph as to what is being referred to, whether it is a model or a rating system.		European Savings and Retail Banking Group (ESBG)	Publish
2	General topics	1.9 General principles for the implementation of a changed or extended model	26	12	Amendment	Current formulation: "The ECB generally expects this time frame to be no longer than three months from the date of the notification." Please adjust this to reflect COREP reporting dates: "… no later than at the end of the following quarter for COREP reporting"	The amendment does not lead to any additional delay in COREP reporting		European Savings and Retail Banking Group (ESBG)	Publish
3	General topics	2.6 Reversion to a less sophisticated approach	41 to 45	17 to 19	Clarification	The ECB guide is very prescriptive in relation to the documentation to be provided in the application for reversion to less sophisticated methods but does not explain how the ECB will assess the documentation in order to decide whether or not to approve the application. It would be interesting to include how the ECB interprets that the articles of the CRR mentioned are complied with			European Savings and Retail Banking Group (ESBG)	Publish
4	General topics	2.7 Internal models in the context of consolidations	48	19	Clarification	In should be included a paragraph similar to paragraph 45 on "Guide on the supervisory approach to consolidation in the banking sector"	It should be clear that "In principle, ECB Banking Supervision aims for the supervisory requirements to remain stable provided that additional risks are adequately covered", in other words, it cannot be the case that the RWAs of two merged institutions are higher than those of the two institutions separately.		European Savings and Retail Banking Group (ESBG)	Publish
5	General topics	2.7 Internal models in the context of consolidations	48	19	Clarification	Which ECB decision is the Guide referring to? Is it the decision related to Article 146 CRR ?	Clarification of content.		European Savings and Retail Banking Group (ESBG)	Publish
6	General topics	2.7 Internal models in the context of consolidations	49	19	Amendment	We would suggest to amend the sentence "Institutions are expected to submit a "return to compliance plan" explaining how they will return to compliance with regard to all consolidation-related compliance issues" by replacing "all consolidation-related compliance issues" with "model related compliance issues".	Better definition of the scope of the compliance plan.		European Savings and Retail Banking Group (ESBG)	Publish

7	General topics	2.7 Internal models in the context of consolidations	49	19	Clarification	What is the timeframe for submission of the return to compliance plan after the acquisition date?	Clarification of regulatory expectations.		European Savings and Retail Banking Group (ESBG)	Publish
8	General topics	2.7 Internal models in the context of consolidations	49	19	Clarification	Is our understanding correct that the return to compliance plan would replace any potential TPU application?	Clarification of regulatory expectations.		European Savings and Retail Banking Group (ESBG)	Publish
9	General topics	2.7 Internal models in the context of consolidations	46 - 49	19	Clarification	Are the rules in Chapter 2.7 referring only to the business combinations as defined in paragraph 6 of the Guide on the supervisory approach to consolidation in the banking sector? In this case, is our understanding correct that simple portfolio acquisitions (purchase of additional exposures without acquiring the share on the entity) are not covered by Chapter 2.7?	Clarification of the scope of the chapter.		European Savings and Retail Banking Group (ESBG)	Publish
10	General topics	2.7 Internal models in the context of consolidations	49	19	Clarification	It should be explicitly included that in case of missing data in consolidations, the MoCs only have to be applied on the adquired portfolio			European Savings and Retail Banking Group (ESBG)	Publish
11	General topics	3.5 Understanding of the rating systems	64	23	Amendment	One word is obviously missing (indicated in bold): "(b) …form and frequency of management **reporting** are adequate …"	Correction of misleading typo		European Savings and Retail Banking Group (ESBG)	Publish
12	General topics	6.2 Use test requirement	96	38	Amendment	The current formulation of "minimum 3 years at time of application" would lead to significant delays in rollout plans and minimize the value-added by implementing risk-sensitive capital requirements. We suggest to adjust the wording slightly to reflect "at least 3 years at time of implementing the IRB approach"	Avoiding significant delays when introducing new IRB entities or model segments		European Savings and Retail Banking Group (ESBG)	Publish
13	General topics	6.6 Assignment of exposures to grades or pools	111 (b)	45	Deletion	The added phrase seems to duplicate what was already there: "i.e. if there is a situation that systematically triggers an adjustment *and that could justify an adjustment to the model (for example the inclusion of a specific risk driver).*" In our interpretation both situations are essentially the same: systematically triggereing an adjustment and adjusting the model by adding a specific risk driver mean the same thing.	The new addition is just replicating/doubling on already existing paragraph and might create inconsistencies in interpretaion.		European Savings and Retail Banking Group (ESBG)	Publish
14	Credit risk	2.2 IT systems: infrastructure and implementation testing	7	61	Amendment	Paragrap 2.2.2: Please replace the word "fully" in the phrase "It should also be able to fully replicate the execution of the model and the calculation…" with the word "broadly" - "It should also be able to broadly replicate the execution of the model and the calculation ´.."	In order to avoid unduly costs and efforts for the creation of a 1:1 environment of the fully fledged process.		European Savings and Retail Banking Group (ESBG)	Publish
15	Credit risk	2.2 IT systems: infrastructure and implementation testing	8	62	Amendment	Paragrap 2.2.2: Punctuation within brackets might cause misinterpretation. Sould be ", it" instead of ". It"	Correction of misleading typo		European Savings and Retail Banking Group (ESBG)	Publish
16	Credit risk	2.2 IT systems: infrastructure and implementation testing	8	62	Clarification	In the event of a model change, it should be sufficient to provide the functional and technical implementation concepts including for systems testing (on the basis of a corresponding simulation environment) as evidence for the ability to provide a new version of the relevant IT systems.			European Savings and Retail Banking Group (ESBG)	Publish
17	Credit risk	3 Use of data	33	69	Amendment	"Since the data-related requirements of the CRR also apply in cases where an institution estimates CCFs, paragraph 0 is also relevant for such institutions." Not clear what "paragraph 0" is.	For clarification.		European Savings and Retail Banking Group (ESBG)	Publish
18	Credit risk	3.2 Use of external data	34	69	Amendment	"Data-related requirements established under the CRR apply to all data: internal, external or pooled. In the ECB's understanding, therefore, paragraph 0 is also relevant in the event that an institution uses external or pooled data". Not clear what "paragraph 0" is.	For clarification.		European Savings and Retail Banking Group (ESBG)	Publish
19	Credit risk	3.6 Use of human judgement	47, footnote 34	74	Amendment	Treating environmental risks by assigning a "conservative rating via override" would conflict with the concept of (unbiased) ratings in the methodological sense (e.g. for the purpose of calibration). Overrides generally must not be conservative. In case of application deficiencies in the assignment process acc. to Par. 196 EBA/GL/2017/16, however, conservatism in the application of risk parameters can be applied.	Avoiding inconsistencies: Conservatism in the application of risk parameters (due to application deficiencies) versus overrides as part of the (unbiased) rating assignment process for methodological purpose.		European Savings and Retail Banking Group (ESBG)	Publish

20	Credit risk	4.2 Consistency of the application	63	79	Deletion	"In the ECB's understanding, it is best practice for institutions to foster consistency within the process related to the default identification by also applying these requirements to joint credit obligations involving non-retail exposures."	Avoiding of enlargement of scope of EBA Guideline EBA/GL/2016/07 only for SSM institutions.		European Savings and Retail Banking Group (ESBG)	Publish
21	Credit risk	4.2 Consistency of the application	64	79	Deletion	1. The concept of an obligor, i.e. the natural or non-natural entity being responsible to repay a certain exposure, is essential part of all credit risk processes and regulations. We consider the introduction of a new type of obligors as inconsistent with the currently applicable Art. 147 CRR unless the concept of JCOs is fully reflected in internal risk management practices (e.g. in case of obligor-based rating assignment or default identification). 2. On methodological grounds we agree that the existence of joint credit obligations must be properly considered in risk models due to the described effects, and the correlation this introduces between the joint obligors. Such effects, however, might be verified by proper calibration tests on sub-segment level (e.g. comparing sub-segments with joint obligors and without). We suggest to remove the (unconditional) need to treat such constructions separately Alternatively, you may replace it by methodological requirements (e.g. homogeneity tests) in line with the standard understanding of "credit obligors" for the respective rating methods.	Re 1: The basic foundation of risk management (the understanding of an obligor) was adjusted for the purpose of updating the definition of default in the EBA GL on DoD but without necessarily changing internal risk management practices with respect to the level of application. Expanding this concept beyond the scope of this guidelines by changing the level of application and explicitly requesting JCOs to be treated like a separate obligor seems to go beyond a pure interpretation of legal requirements. Such fundamental changes should require alignment with EBA before enforcing it. Re 2: The potential inhomogeneity caused by joint responsibility for credit exposures can be handled by state-of-art modelling and validation techniques: Information of both obligors may be considered for rating assignment. Homogeneity tests shall ensure that resulting PDs are unbiased for both single and joint obligors. In this sense the added complexity seems redundant from a risk quantification perspective, would trigger significant investment needs and would even increase modelling complexity by introducing artificial (highly correlated) clients. As a consequence, implementation of this requirement would be considered unduly burdensome.		European Savings and Retail Banking Group (ESBG)	Publish
22	Credit risk	4.3 Days past due criterion	69	81	Deletion	This paragraph essentially requires the implementation of an alternative days past due counter for any country not within SSM responsibility. This is considered high effort and does not justify the minor improvements in credit risk steering, considering the fact that: 1. The absolute threshold is only relevant for small exposures (irrelevant for high exposures) 2. In most cases local materiality thresholds are set more conservatively compared to the Euro value, properly considering potential variations in FX rates. We kindly ask for removal of this condition. Alternatively, you may replace it by a more flexible, potentially conservative, formulation without the need to implement a second days past due counter unconditionally.	The current formulation might lead to significant investment needs with limited added-value from risk steering perspective		European Savings and Retail Banking Group (ESBG)	Publish
23	General topics	4.3 Content and frequency of tasks of the validation function	77	31	Clarification	It is said that it can take into account the benchmarking performed by the CRCU: Does it means that it is mandatory for the CRCu to perform it?			European Savings and Retail Banking Group (ESBG)	Publish
24	Credit risk	4.3 Days past due criterion	73	82	Amendment	It appears to be an inconsistency between the EBA GL on definition of default and the ECB GL on IM regarding technical defaults that would need to be amended. Our understanding based on paragraph 23 of the EBA DoD Guidelines, point (a), is that manual or data system errors should be classified as technical default since no past due criterion is actually met. For this reason, we request that the ECB's understanding of this point should be amendeded to be aligned with the EBA guidelines.			European Savings and Retail Banking Group (ESBG)	Publish
25	Credit risk	4.4 Unlikeness to pay criterion	79	84	Deletion	The justification for "the calculation should also be performed in cases where the threshold is blatantly exceeded" is based on LGD data requirements. Clearly, for LGD modelling purpose, detailed information on write-offs and restructurings are needed. However, the values from the calculation of diminished financial obligation according to the GL On DoD is not needed for LGD estimation, as there are different requirements to be applied (e.g. different discounting, consideration of costs, etc.). In this sense the required calculation is not needed for LGD data requirements.	Avoiding undue and unjustified cost in operative risk management		European Savings and Retail Banking Group (ESBG)	Publish

26	Credit risk	4.7 Adjustments to risk estimates in the case of changes to the definition of default	91	88	Amendment	The current formulation unconditionally requires full redevelopment under described situation. EGB kindly asks to allow for more flexibility, as there are different options available between pure recalibration (which is clearly insufficient under the described circumstances) and full re-development. We propose a formulation to require a full Review of Estimates in that case, triggering the appropriate follow-up activity.	Current formulation is too black-white. The update should allow for more flexible approaches to adjust models properly.		European Savings and Retail Banking Group (ESBG)	Publish
27	Credit risk	4.7 Adjustments to risk estimates in the case of changes to the definition of default	92	88	Amendment	For any adjustments to the definition of default, a quantitative estimate of the impact of the application of the new definition of default is required either in the form of a retrospective simulation, a parallel run or a similar classification of the reference data set. In addition, we ask for the possibility to qualitatively estimate the impact based on an expert opinion in the case of minor qualitative adjustments to the definition of default.			European Savings and Retail Banking Group (ESBG)	Publish
28	Credit risk	5.1 Structure of PD models	105 & 106	95	Clarification	Related to articles 105 and 106, the guides should ensure a better interpretation of the grade assignment dynamics also. The requirements awareness the institutions to find the relationship between the definition of risk drivers, the number of grades, migrations across risk grades, changes in the one-year default rates over time, and the dynamics and volatility of capital requirements. However, there's a lack of information and comprehensiveness about the criteria that institutions should follow to guarantee that a good performance of the model is met. For example: ¿what is considered an "appropriate balance" in section 105. (a)?. In reference to Section 105 (c): does not specify what to do if you do not have the driver information in those years.			European Savings and Retail Banking Group (ESBG)	Publish
29	Credit risk	5.1 Structure of PD models	109	97	Clarification	Paragraph 5.1.4: The ECB states: "institutions should not assign a rating to an obligor that is better than the rating of the third party". Considering that the rating of the 3rd party may come from a different rating system/rating scale, one should compare PDs instead of ratings.	Alignment of terminology with Par. 108 and Par. 110		European Savings and Retail Banking Group (ESBG)	Publish
30	Credit risk	5.2 PD risk quantification	122 (b)	100	Deletion	Paragraph 5.2.2: See our comment on §64 in Section 4.2 Consistency of the application	See our comment on §64 in Section 4.2 Consistency of the application		European Savings and Retail Banking Group (ESBG)	Publish
31	Credit risk	5.2 PD risk quantification	130	104	Clarification	From our point of view and taking into account its relevance in the calculation of LRA, the guides should consider to incorporate major details on the concept 'likely range of variability' and 'good and bad years'. The guides should include references to answer questions like: How many years are the minimum to compute a calculation of LRA? The classification of a year as good or bad, should be based only on internal data? Is it necessary to consider external data like macroeconomic variables? Is it expected to combine internal and external data? The guide should specify a list of methods that could be used to determine whether a year is good or bad. For instance: Comparison between the ODR of a given year with the mean of the observed period. A year with ODR higher than the mean of the period, can it be considered as bad year? Is there a threshold that should be used to classify a year as bad? Models based on external data like Markov Switching model. Are acceptable? If not, why not? Furthermore, paragraph 130 e) only makes reference of the adjustment when bad years are underrepresented, but there is no reference to the situation where bad years are overrepresented. What are the guides when the bad years are overrepresented? Is it acceptable to estimate one-year-default rate through a model to amend the overrepresentation?			European Savings and Retail Banking Group (ESBG)	Publish

32	Credit risk	5.2 PD risk quantificatio n	130 (a)	104	Amendment	Paragraph 5.2.3: The closing statement "under no circumstances should an approach be adopted to overcome data scarcity at grade or pool level, ..." would mean that statistically unreliable non-parametric approaches must be applied in case of scarce data. In this sense we kindly ask to remove the reference to data scarcity.	The requirement not to select appropriate methodologies to overcome data scarcity is the opposite to what should be done with proper statistical modelling. Methodologies for low default portfolios are specifically defined to overcome issues on data scarcity. Differentiation in regulatory requirements between non-retail (e.g. 7 years of data) and retail (minimum5 years) are mostly focused to handle the situation of reduced data appropriately. In this sense we kindly ask to remove this closing condition, as this is not in line with advanced statistical approaches and might easily lead to excessive variability in low default portfolios. Such a restriction would become a huge burden for low default portfolios in IRB		European Savings and Retail Banking Group (ESBG)	Publish
33	Credit risk	5.2 PD risk quantificatio n	130 (c)	105	Amendment	Paragraph 5.2.3: The unconditional requirement to "take all reasonable efforts to obtain such long series with sufficient data quality" seems excessive. Depending on the grade assignment dynamic (e.g. pure PIT or TTC models) or the applied calibration methodology, a shorter series (of best possible quality) may be sufficient.	The requirement should properly reflect different rating philosophies. For example one might construct a TTC rating system by transforming (=aligning) the score distribution at each point in time, before assigning risk grades. This way the rating distribution would not change over time and the need to "take all reasonable effort to back-simulate ratings" would be excessive.		European Savings and Retail Banking Group (ESBG)	Publish
34	Credit risk	5.2 PD risk quantificatio n	135	107	Deletion	Paragraph 5.2.3: The closing part states: "In any case, even if the deviations are not systematic, the ECB expects institutions to demonstrate that such grade-level deviations do not distort the RWEA calculations...". We kindly ask to remove the final statement requesting simulation even for non-systematic (and statistically non-significant) deviations.	Avoiding undue and unjustified cost in operative risk management: Although the guideline explicitly allows for 2 alternative solutions, this paragraph would request implementation of both simultaneously. 1. For each rating systems, a grade level calibration (including any required analysis for MoC etc) has to be performed as well, and 2. any "non-systematic" random deviation needs to be factored into RWA. Similarly to our argumentation on §130(a) this would lead to unjustified variability of reported results, on top of doubling the effort for any calibration activity. To give a simple example: a single default from AAA during 2008 in a banks portfolio might indicate a 1% "grade level" default rate in that grade. A simulation of RWA impacts with such a grade-level approach would not add value.		European Savings and Retail Banking Group (ESBG)	Publish
36	Credit risk	5.2 PD risk quantificatio n	137	108	Amendment	Paragraph 5.2.3: The reference to "new override policy" seems overly specific. We suggest to replace this by "potentially updated override procedures"	Seems to be too specific		European Savings and Retail Banking Group (ESBG)	Publish
37	Credit risk	6.2 LGD structure	172	121	Amendment	Paragraph 6.2.1: ESBG would like to point out that, in order to increase the representativeness of the LGD development sample to its application scope, the better approach is to chose a fixed-time approach where the observations 12 months before default are used. Indeed, the farther away from the default, the more similar will the risk features of the facilities be to the performing application portfolio. Typically, the usage of behavioral risk drivers (which change significantly when the facility is approaching default, e.g., days past due) in LGD produce models that are highly correlated with PD (a property that is understood to be not desirable), and where the prediction is very granular for "bad" grades, and is affected by high concentration in the "good" grades when analysing the application portfolio. Indeed, it is EGB's understanding that one of the requirement of representativeness as set out in EBA GL on PD and LGD, art. 24, is that the distribution of the risk drivers in the modelling sample must be comparable to the one in the application portfolio. This can typically only be achieved when using a 12-months fixed time horizon, since observations closer to the default skew the drivers distribution towards "worse" values. EGB would also like to point out that changes in product mix due to restructurings occurring before default can be properly taken into consideration by means other than variable-horizon approach, e.g., reconciliation of the loss to the "parent" account in the RDS, without prejudice to the representativeness principle discussed in the previous paragraph of this comment.	To increase the representativeness of the LGD development sample		European Savings and Retail Banking Group (ESBG)	Publish
38	Credit risk	7.2 Realised CCFs	199	135	Clarification	Paragrapg 7.2.1: "...those requirements as set out in paragraphs 0, 204, 205, 206 and 210(b) of this chapter" - typo "paragraph 0".	Typo correction.		European Savings and Retail Banking Group (ESBG)	Publish

39	Credit risk	7.4 CCF risk quantification	204 (c)	140	Amendment	There is an inconsistency between the CRR and the ECB guidelines that should be clarified on this point. Article 182.1.a of the CRR reads as follows: *Requirements specific to own-conversion factor estimates* *1. In quantifying the risk parameters to be associated with rating grades or pools, institutions shall apply the following requirements specific to own-conversion factor estimates:* *(a) institutions shall estimate conversion factors by facility grade or pool on the basis of the average realized conversion factors by facility grade or pool using the default weighted average resulting from all observed defaults within the data sources;* From the previous article it can be deduced that the CCF must be calculated as a default weighted average from ALL observed defaults. However, in the ECB guidelines in paragraph 204.c of this new guide it is indicated that: *When the historical observation period is considered to be representative of the LRA, the average realized CCFs should be computed as the arithmetic average of the yearly averages of realized CCFs in that period.* Bearing in mind that the default weighted mentioned in the CRR is explained in the EBA guidelines in the LGD part and is expressed in paragraph 150 *Without prejudice to Article 181(2) of Regulation (EU) No 575/2013 institutions should Calculate the long-run average LGD as an arithmetic average of realized LGDs over a historical observation period weighted by a number of defaults. Institutions should not use for that purpose any averages of LGDs calculated on a subset of observations, in particular any yearly average LGDs, unless they use this method to reflect higher weights of more recent data on retail exposures in accordance with Article 181(2) of Regulation (EU) No 575/2013.* For all the above, it is necessary to clarifyif the estimate CCF should be computed as "default weighted average resulting from all observed defaults within the data sources" or as is said in the ECG guide it should be computed as " the average realized CCFs should be computed as the arithmetic average of the yearly averages of realized CCFs in that period."			European Savings and Retail Banking Group (ESBG)	Publish
40	Credit risk	7.4 CCF risk quantification	207	141	Clarification	We would like to clarify regarding point "(b) iii" that it is not necessary to apply an additional MoC to the CCF of 100%, but what is requested is that once the MoCs considered necessary have been added, this final CCF with MoC must to be a minimum of 100%.			European Savings and Retail Banking Group (ESBG)	Publish
41	Credit risk	7.4 CCF risk quantification	207	141	Amendment	It seems to us that a minimum CCF of 100% is not justified, since there may be portfolios that are not significant and for which there is not enough information available but in which a CCF of less than 100% can be defended.			European Savings and Retail Banking Group (ESBG)	Publish
42	Credit risk	8.1 Relevant regulatory references	208	140	Amendment	Applying mocs at grade or pool level can lead to overestimates. It would be useful to find arguments for mocs to be applied at less conservative levels such as at the calibration segment level.			European Savings and Retail Banking Group (ESBG)	Publish
43	Credit risk	8 Model-related MoC	137	53	Amendment	The requirements regarding internal model validation should not apply at the level of the third-party-provider but only at the level of the individual rating model. Otherwise, the resulting interference with the business model and organizational setup of the third-party provider would not be reasonable.			European Savings and Retail Banking Group (ESBG)	Publish