



EUROPEAN CENTRAL BANK
BANKING SUPERVISION

Template for comments

Public consultation on the ECB guide to internal models - General topics chapter

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General comments

ID	Section	Paragraph	Page	Type of comment	Detailed comment	Concise statement as to why your comment should be incorporated
1	Model use	Assignment of exposures to grades or pools	39	Clarification	<p>Paragraph 95-a) The first aspect that should be clarified by ECB is if a certain (marginal) share of UR, within an AIRB perimeter, is allowed or if the UR should tend to zero by definition (both in term of numbers and in terms of exposure / EAD/ RWA); the current share of UR could be related to the model design – currently validated and in use by the Institutions – (e.g. balance sheet not available for the newco, foreign counterparties, etc.) or for specific characteristics of a given counterparty within an AIRB portfolio (e.g. Institutions).</p> <p>Considering the previous general observation, ISP deems appropriate the proposed approach allowing for a prudential treatment for outdated rating (e.g. time-dependent downgrading for outdated rating).</p> <p>On the contrary, some doubts are related to the proposed process for the UR counterparties. The prudential treatments (“...the attribution of the worst performing rating grade”) can be considered appropriate if it is related to the share of “unjustified UR” (e.g. situations where a counterparty is UR, but all the implemented conditions – validated by the competent authority within the model framework – for the rating attribution are fully verified). In this scenario, it is reasonable to apply the described prudential approach until the rating will be attributed.</p> <p>Instead, when the unrated is justified (within the validated model framework) the proposed prudential approach should be reviewed considering also the methodological approach used for the Long Run Average Default Rate (LRADR) calculation. For example, when the LRADR (used for PD calibration purposes) is computed including the subset of unrated counterparties in the historical reference perimeter, it should be considered that this usually lead to an implicit penalization (a higher overall LRADR) for the sub-sample of rated counterparties (e.g. the SME Corporate UR have usually a higher default rate with respect to the one observed for the rated counterparties). In this case, the use of specific “PD benchmark” should be allowed (e.g. two LRADR should be calculated: one for the rated and one for the attribution of a benchmark PD for the UR sub-sample).</p> <p>In general term, the following aspects should be evaluated in defining the logic for managing UR counterparties:</p> <p>I. Methodological aspects (e.g. model review), which could be relevant and hence subject to specific approval by ECB (e.g. new model change application)</p> <p>II. New PPU applicators in order to define a precise sub-perimeter (within each AIRB portfolio) where the standard treatment is allowed (e.g. specific cluster of counterparties, currently UR, should be moved in a new PPU sub-segments). Moreover, ECB should apply a greater level of flexibility in evaluating the (new) PPU requests for specific sub-samples of counterparties / types of exposure, considering that, within some portfolio (e.g. Institutions), several counterparties’ features (e.g. type of business, economic/financial structure, complexity of the organization, etc.) make the rating attribution objectively difficult</p> <p>III. Impacts on the Institutions’ internal process (e.g. process, pricing, etc.) and on their organizational structure</p> <p>IV. IT impact</p> <p>V. ECB’s related effort (e.g. ex-ante / ex-post notifications, new model change application, PPU application...)</p> <p>Moreover, an appropriate period of time and a progressive approach (eventually based on materiality of the portfolio/model) should be allowed for the Institutions to be fully compliant with the ECB’s requirement.</p>	The request for clarification is supported with some suggestion
2	Internal audit	Scope and frequency of the review of the rating systems	31	Clarification	<p>Paragraph 84) this paragraph is not sufficiently clear. We would like to have confirmation that if a material change is reviewed by internal validation we don’t necessarily need another review performed by Internal Audit. So, for the extensions and changes to the IRB approach the independent review or validation has to be only performed by the Internal Validation function.</p>	To avoid useless workload as a consequence of a double review
3	Management of changes to the IRB approach	Re-rating process	47	Clarification	<p>Paragraph 121b) ISP deems appropriate the proposed approach, allowing for a prudential treatment to mitigate the risk of underestimation of own found requirements, but there are some aspects that should be clarified by ECB, regarding the way to put in place the approach considered the most appropriate, with the aim of not creating distorting effects in the calculation of capital requirements.</p> <p>ISP would like to highlight the complexity induced by the application of this paragraph, as it will require a high level of new development in terms of calculation tools, in order to carry out the application of the simulated RW exposure amount impact at the maximum level of detail of each transaction, to fill in COREP templates.</p> <p>The guide should provide details on how the additional RWA exposure should be considered in the capital calculation.</p> <p>Furthermore, regarding linear removal of the impact, ISP notes that re-rating process could not be linear and so it deems appropriate that removal should be in line with the progressive re-rating percentage, quarter by quarter, to avoid double counting.</p> <p>Finally, regarding the case of a material decrease in the RW exposure amount, ISP asks to clarify the treatment to put in place.</p>	ISP would like to highlight the complexity induced by the application of this paragraph and the possible double counting on RW caused by the paragraph
4	Model use	Assignment of exposures to grades or pools	38	Amendment	<p>Paragraph 94) Regarding outdated rating and method to individuate the expiration date, ISP submits the rules currently in force that seems more prudential in order to guarantee the alignment of rating with risk profile of counterparties and preserve the use of the most up-to-date set of information.</p> <p>The expiration date is consistent with validity of information set and in detail:</p> <ul style="list-style-type: none"> • if financial information, taken from balance sheets, are used in rating assignment process, this date is consistent with their validity. It is noted that balance sheets have to be dated no more than two years except for Public Sector Entities perimeter for which balance sheets have to be back no more than two and a half years in accordance to their availability. So for example, if rating is assigned in June 1st 2018 and financial statement data is 31/12/2016, expired data is 31/12/2018) • if financial information is not used in rating assignment process, the expiration date is one year after assignment date of rating (e.g. for Retail counterparties or rating of Corporate counterparties involved in Specialized Lending Transactions) • In all cases, except for Retail counterparties, Specialist Rating Valuation Sub-Department can always reduce the date of rating expiration. <p>Moreover ISP have in force both monitoring rating produced monthly with most update data and some automatic processes that: i) intercept automatically deterioration of rating ii) if deterioration persist, automatically downgrade the rating (every three months) iii) do not make rating usable in credit granting process and in some cases quite apart expiration of rating.</p> <p>Finally it is noted that when rating expired, it is subject to another downgrade process every three months.</p> <p>In all these cases rating is not valid for a new credit proposal.</p>	Rules currently in force seems more prudential than the proposed ones