EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Template for comments

Public consultation on the revised ECB guide to internal models

Institution/Company

European Banking Federation

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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
1	General topics	1 Overarching principles for internal models			Clarification	The industry would welcome a clarification in terms of timeline of the implementation of the updated version of the EGIM. This is especially important given that the final regulatory text of the banking package might require further changes to the EGIM. Significant Institutions should know in advance when the updated version of the Guide is going to be considered in the model change processes in progress. The ECB Guide and the subsequent model validations should be consistent with the final text of the Capital Requirements Regulation (CRR3) which entry into force is currently foreseen in 2025.	Timeline of implementation
3	General topics	1 Overarching principles for internal models			Amendment	We propose to include a paragraph in the overarching principles of the EGIM: EBA Guidelines on PD-LGD estimation have been specified in a flexible manner, to accommodate various estimation methodologies and types of portfolios. Especially in the phase of model development, it is the ECB's understanding that institutions may use data and methods that are considered most appropriate for a given portfolio. While human judgement is an integral element of all models it is expected that in the case of models for low default portfolios it may be used to a greater extent. In the same vein, in case of data scarcity because of the low volume of defaults, the risk parameter calibration methods could be adapted to the structure of data, in order to ensure that the model outcomes reflect economic reality. We believe this EBA concerns about LDP portfolios and in particular the necessary flexibility advised in its GL on PD-LGD estimation to accommodate for various estimation methodologies and types of portfolios should be reflected in the "Overarching principles for internal models". More generally, flexibility is also needed for LDP portfolios in the detailed expectations regarding modelling.	
4	General topics	1.6 General principles for internal validation			Amendment	The Guide states that effective independence of the internal validation function from the model development process shall be ensured and, therefore, institutions should have appropriate organisational arrangements in place. According to this principle, in order to ensure independence of the validation function from the function responsible for model development process and to allow for an objective assessment of the rating systems, the Regulation sets three different possible organisational arrangements, depending on the nature, size and scale of the institution and the complexity of the risks inherent in its business model. Since every bank has its own specific organizational model and governance framework, hence, the Guide should allow the supervisor to take those specificities into account. As Regulation 2022/439 explicitly allows G-SIB and O-SIB to choose from option a) or b), the EGIM should not prevent this possibility. Institutions adopting option b) may consider reserving the appointment of the Head of the internal validation function to the Management Body in its supervisory function.	
5	General topics	1.8 General principles on climate-related and environmental risks			Clarification	The EBF will communicate on this topic in due course	

6	General topics	1.9 General principles for the implementation of a changed or extended model			Amendment	The requirement to implement model changes within 3 months after notification of approval is hardly feasible in practice. A more flexible approach is needed instead of a fixed, pre-defined deadline. The ECB should take into consideration the tasks involved: - Bank's requests of clarifications on the potential changes and adjustments required by the ECB - Implementation of possible complex IT changes and adjustments - The protocols to put changes in practice in an orderly fashion The tightness of the 3-month period is all the more stringent in the case of models that have to be implemented across different jurisdictions and are subject to the approval of multiple supervisors. If it was deemed inevitable to introduce a general upper limit for the implementation period, it should not be less than 12 months	
7	General topics	2.4 Changes to the roll-out plan for the IRB approach			Amendment	In our view, the concepts of materiality / immateriality as per article 150(1) of CRR should only be a help to decision-making as the final choice for PPU (and in mirror the choice for roll-out) is not purely based on quantitative criteria (EAD / RWEAs) but also relies on qualitative criteria. For example, data constraints may drive the choice to keep the exposures of a business unit or exposure class / type treated under the standardised approach. It should be noted that the draft RTS on roll-out and PPU (EBA/CP/2014/10) which is referred to in ECB Guide have never been finalised by the EBA	
8	General topics	2.6 Reversion to a less sophisticated approach			Amendment	Revisions to less sophisticated approaches have been and will continue to be a key concern for institutions. Thus, in principle we support the attempt to clarify this issue with additional guidance. However, it should be noted that the respective level 1 requirements are about to change. With CRR III coming into force, the model landscape will change significantly and a whole new partial use philosophy will prevail. This should be anticipated and reflected in the EGIM. In particular: - The guide should reflect Article 494d of the CRR III draft. Article 494d in CRR3 allows institutions to revert to the SA-CR during a three-year period subject to competent authorities' approval under a simplified procedure. This should be anticipated and reflected in the EGIM. This should be anticipated and reflected in the EGIM. - It should be clarified that legally required reversals do not trigger any application and approval process	
9	General topics	6.2 Use test requirement			Amendment	The extension may refer to the application of the IRB Approach to existing LEs/BUs for which the application of internal models was not requested or authorised, as well as the extension to new LEs/BUs established either to run new businesses or to run existing businesses under the perimeter of the already authorised models. The latter cases can be better referred to as spin-offs of the existing scope of application of the IRB Approach, as such deserving some additional understanding in order to avoid an unintended and unjustified reversal to a less sophisticated approach. To this purpose it might be clarified that the provisions of paragraph 97 shall be applied with no prejudice to the continued application of the IRB approach to exposures within the scope of the existing coverage of the IRB approach eventually transferred to the new LE/BU. Moreover, within the case of extension to additional exposures that are not significantly different from the scope of the existing coverage shall be considered the opportunity to acknowledge that spin-offs may be considered as having met the conditions of CRR article 145 (1) and (2) considering the existing experience of the institution also for the purpose of application of the IRB approach at both individual and consolidated level under point (b) and not only for the purpose of its application at consolidated level only under point (a)	
10	General topics	6.6 Assignment of exposures to grades or pools			Clarification	In our view, it should be clarified that only ratings that are solely based on outdated rating details are considered as outdated. For instance, retail ratings are inevitably partially based on older rating details as some rating details are gathered only at application. This should not automatically lead to the rating itself being classified as outdated. In particular, as no yearly update of financial statements is given for retail clients, institutions need to be able to use older financial statements without the whole rating being deemed outdated	
11	General topics	7.5 Impact assessment			Amendment	The nine-months rule (requirement that the time between the reference date and the date of notification shall not exceed nine months) should be feasible in most cases. However, there might be cases where the snapshot has to be older. Exception for well documented cases should be possible, for example: - Where external data delivery is needed for the calculation - Where manual input is needed for the re-rating	

12	Credit risk	2.2 IT systems: infrastructure and implementation testing			Amendment	It is our understanding that the introduction of this chapter aims at improvements in two areas: 1) the ability to execute the model, i.e. to provide own funds requirements and impact assessments 2) the ability to provide evidence that the model is ready to be implemented in a timely manner after the approval. With regard to paragraph 7, the explicit requirement that the institution "has implemented the proposed model into a live or, if duly justified, non-live production environment" is disproportionately burdensome. The implementation of a model change into non-production environments could in some cases increase operational risk through the maintenance of multiple "production like" environments and result in large overheads in maintaining code integrity whilst awaiting approval. At the same time, the above-mentioned objectives can be met with less severe drawbacks. The time needed to have already implemented all IT evolutions (at least in a non-live environment) and validated them through acceptance tests, including evolutions in risk management and reporting processes, would induce an important delay between the end of modelling works and the actual submission of the application package to the ECB. For instance, any additional guidance on the IT implementation of a new model should be limited to the following: 1) at the time of model submission, institutions should be able to run high quality impact assessments in a timely manner on the new model utilising latest required input data. Subsequent impact assessments should also utilise the same model with the latest required input data to preserve integrity of the assessments. 2) institutions should be able to provide full evidence of the entire implementation of a model change in advance of the on-site audit review. This allows that the model is implemented end-to-end in a timely manner post approval. At the same time, business readiness should be embedded in the institution's policies and processes upon model submission. With regard to the IT implementation of model changes, no additional guidance or requirements are needed at all. The existing processes are sufficient. When an existing model is changed, the assessment can be done based on existing production and testing procedures. Additional requirements will eventually lead to a significantly increased time to market for improved models. It is neither in the interest of supervisors nor banks, that model improvements are delayed for an unnecessarily long time due to bureaucratic reasons. Therefore, paragraph 8 should be dropped. Moreover, the issues mentioned above are magnified by the fact that the waiting time for supervisory approval is not regulated. In practice, it is usually very long and hardly predictable. Supervisory authorities should make a stronger commitment to ensure timely decisions and at least provide more planning certainty.	
13	Credit risk	3.7 Use of data in the case of consolidations			Amendment	There might be cases where the default history of an acquired portfolio is not representative to an extent which cannot be healed by appropriate adjustments. For example, the target recovery strategy and process that the acquired portfolio will be subject to within the acquiring entity may largely differ from the recovery strategy and process of the seller. Therefore, institutions should be allowed to exclude such data where justified in the understanding that the acquired portfolio is not in scope of the acquirer's existing models.	
14	Credit risk	4.2 Consistency of the application			Amendment	First, with reference to paragraph 60, we believe that ECB Guide should not add requirements to EBA Guidelines on the Definition of Default regarding information gathering on the obligor's behaviour in a consolidated way across the banking group. Second, the risk management and monitoring framework is based on EBA Guidelines on the definition of default which defines EUR materiality thresholds to start counting the number of days past due. A change in the detection of the past-due exposures could lead to significant IT and operational changes. We believe that ECB Guide should not go beyond the requirements of EBA GL in paragraph 85. and thus, that immaterial past-due amounts, such as small amount of fees and commissions should not prevent a return to non-default status. If the obligor is experiencing severe financial difficulties, this should be observed in past due amounts in excess of EBA-defined thresholds. Third, it should be noted that the application of ECB draft expectations on joint credit obligations for the non-retail scope as the notion of liability of borrowers is not homogeneous across transactions (e.g., extent of liability, partners, co-owners, guarantees, cash pooling …) and it would be extremely complex and burdensome to apply this notion. Rather than a "best practice" for non-retail exposures, the requirements for joint credit obligations could therefore be a "nice to have".	
15	Credit risk	4.3 Days past due criterion			Amendment	The EBA guidelines specify that any past due amount of principal, interest or fee should be recognised as a credit obligation past due in the past due default criterion. The ECB expects unpaid maintenance fees for deposit accounts to be included in fees in this context. Unpaid fees for non-credit related products represents an insignificant part of total past due amounts for institutions and should, in our view, therefore not have to be considered in the calculation of the days past due criterion. This to reduce the complexity for institutions. Some aspects related to the definition of default raise some concerns for the industry. In particular, those that refer to the way to identify defaults for clients present in more than one jurisdiction; to the application of a daily exchange rate for the calculation of the threshold; to the requirements regarding the reconstruction of the RDS once a change has been made to the definition of default or to the consideration about technical defaults. In our view, there is a partial contradiction between the treatment of disputes (para. 71) and technical defaults (para. 73). In particular, according to the last sentence of para. 73, the ECB has the expectation that disputes are not treated as technical defaults. At the same time, para 71 clarifies that disputes can lead to a DpD counting suspension. Consequently, it there should be allowed to treat such defaults due to disputes similarly to the technical defaults. When addressing the technical default potentially stemming from moratoria, the EGIM clarify that only moratoria granted before the obligor reached 90 days past due can be classified as such. In this way it is disregarded the necessary alignment with the retroactive effects of moratoria established by applicable laws. To account for them it is deemed appropriate introducing a dedicated provision stating that "moratoria granted based on applicable laws having retroactive effects from a period where the obligor was less than 90 days past due on material obligation might be treated as technical default also in the case the credit decision approving a moratorium was taken when the counter had already reached 90 days.	

16	Credit risk	4.7 Adjustments to risk estimates in the case of changes to the definition of default			Amendment	The EBA guidelines specify that any past due amount of principal, interest or fee should be recognised as a credit obligation past due in the past due default criterion. The ECB expects unpaid maintenance fees for deposit accounts to be included in fees in this context. Unpaid fees for non-credit related products represents an insignificant part of total past due amounts for institutions and should, in our view, therefore not have to be considered in the calculation of the days past due criterion. This to reduce the complexity for institutions. Some aspects related to the definition of default raise some concerns for the industry. In particular, those that refer to the way to identify defaults for clients present in more than one jurisdiction; to the application of a daily exchange rate for the calculation of the threshold; to the requirements regarding the reconstruction of the RDS once a change has been made to the definition of default or to the consideration about technical defaults. In our view, there is a partial contradiction between the treatment of disputes (para. 71) and technical defaults (para. 73). In particular, according to the last sentence of para. 73, the ECB has the expectation that disputes are not treated as technical defaults. At the same time, para 71 clarifies that disputes can lead to a DpD counting suspension. Consequently, it there should be allowed to treat such defaults due to disputes similarly to the technical defaults. When addressing the technical default potentially stemming from moratoria, the EGIM clarify that only moratoria granted before the obligor reached 90 days past due can be classified as such. In this way it is disregarded the necessary alignment with the retroactive effects of moratoria established by applicable laws. To account for them it is deemed appropriate introducing a dedicated provision stating that "moratoria granted based on applicable laws having retroactive effects from a period where the obligor was less than 90 days past due on material obligation might be treated as technical default also in the case the credit decision approving a moratorium was taken when the counter had already reached 90 days.	
17	Credit risk	5.1 Structure of PD models			Amendment	For institutions using the same predefined master scale across all portfolios, the empirical evidence required can hardly be provided. In those cases, qualitative justifications should be sufficient. The requirement in paragraph 103 practically does not allow for the use of a global master scale. This is an improper intervention in the bank steering. It makes comparability between portfolios and a meaningful use test very difficult and thus results in several unwarranted consequences: 1. Without a master scale concept, comparability of ratings from different rating systems is not given anymore. This is especially relevant in case of rating transfer and third-party support. For example, when performing a rating transfer between a subsidiary and its parent – a more concrete example would be a bank subsidiary of a corporate entity, e.g. often the case in the automotive industry – the ratings must be comparable as they are in certain cases either directly inherited or notched according to predefined rules. 2. Also, the rating override process and respective policies are based on the master scale concept. Several parts (e.g. when it comes to notch downgrades or considerations of investment vs. non-investment grade) would need to be reworked from scratch when leaving or collapsing the master scale, with potential inconsistencies and reduced transparency being the result. 3. The concept of sovereign ceiling requires ratings of counterparties and their sovereign to be directly comparable and would hence not work without a master scale concept either. Moreover, the conditions of paragraph 102b and 103 cannot be fulfilled at the same time with sufficient significance, if buckets within rating grades are defined via thresholds on probabilities of default given by a risk differentiation model. Finally, it is not clear what is the difference between a granular scale and a very granular scale, having in mind that ECAI uses mostly 18/25 grades vs 7 grades minimum mentioned in CRR for non-retail. This question raises concerns typically on portfolios for which the comparability with external agencies is important for Benchmarking purposes. Therefore, we propose to drop paragraph 103.	
18	Credit risk	5.2 PD risk quantification			Amendment	The requirements around the use of external data are so complex that it seems inevitable from the start that there will be deviating/inconsistent assessments and findings. For non-retail PD models, the requirements are hard to meet. The prescribed analyses of potential biases are expected to be performed on internal data only. At the same time, it is stated that a lack of statistical evidence will not be accepted as a sufficient indication for the absence of biases. However, such a lack of statistical evidence could likely occur in case of scarce data, especially in case of broad confidence intervals for wholesale portfolios.	

19	Credit risk	5.2 PD risk quantification			Amendment	In general, depending on the calibration approach, there might be deviations between average PDs and LRA default rates for some grade or pools. As far as those deviations do not affect a significant proportion of the relevant population and are not systematic, they should not be automatically regarded as violation of the requirement in paragraph 130. The requirement in point a) of paragraph 130 that “under no circumstances should an approach be adopted to overcome data scarcity at grade or pool level, lack of evidence of discriminatory capacity, homogeneity or heterogeneity across grades” makes the use of calibration segments virtually impossible, in particular for non-retail portfolios. Hence, in our view, paragraph 130 should be dropped as it goes effectively beyond the regulatory scope of EGIM de facto taking away an option that is explicitly granted in the EBA GL. Point b) implies that long-term historical data is available for all relevant risk drivers. This appears to be inconsistent with the requirement to identify recent risk drivers and include them in scoring and rating methods, if relevant. Relevant impacts of a changing environment, for example due to digitisation/ the use of AI, real world crises, changes in regulations, etc., can be reflected only very slowly and thus impair model accuracy. Point e) requires an upward adjustment to default rates if bad years are underrepresented in the available data. However, this issue could also be solved by other measures, such as the use of another year as replacement. The EGIM should thus not unnecessarily limit possible mitigations to upward shifts of default rates. Even if a model is representative over the full time-horizon used for calibration and LRADR calculation, the distribution of risk-drivers might change over time. This can cause goodness-of-fit problems on LR samples. Therefore, it makes sense to analyse the fit between probabilities and default rates not only on LR samples but also on single snapshots and conclude on both outcomes. For this the references in Section 5.2.3 to calibration tests would have to be re-formulated to allow conclusions based on single snapshots to be taken into account. In paragraph 133, if the calibration is performed at calibration segment level , institutions should also test the calibration at grade or pool level. However, it is not clear how the divergence between the LRA default rate at a grade level and the grade level PD value should be computed. For example, when a new model is designed and new risk drivers are added, it could happen that there is no historical information of these risk drivers for defaulted clients. Therefore, it would not be possible to assign a rating grade and subsequently not possible to compute the LRA default rate at grade level. The same issue could arise when institutions should compare the average PD with the one-year default rate and with the LRA default rate at calibration segment level, as described in Paragraph 136. If no historical data is available on (some) of the risk drivers to assign a PD for all the cohorts included in the calibration sample. In that case it wouldn't be possible to compute the APDs for all the historical cohorts. Paragraph 135 states that “… additional tests as part of the development and ongoing monitoring of its models to ensure that the final (post-calibration) PDs reflect the LRA default rate of each grade.” It is not clear if “ongoing monitoring” refers to the annual review of estimates framework or the regular model monitoring (e.g mentioned as part of the model development process in Paragraph 15 of the General Topics chapter).	Calibration of the LRA default rate
20	Credit risk	6.1 Realised LGD			Amendment	Paragraph 153 requires institutions to take into account NPV reductions in case of material forgiveness or postponement of payments. This contradicts both several paragraphs in the EBA GL (e.g. 132, 134, 137) and accounting principles. This requirement should thus be dropped.	

21	Credit risk	7.1 Commitments, unadvised limits and scope of application			Amendment	We understand that only committed limits are considered to be regulatory off-balance sheet items in line with paragraph 195 point b) “consider as “commitment” any contractual arrangement that has been offered by the institution and accepted by the obligor to extend credit, purchase assets or issue credit substitutes.” Therefore, uncommitted limits are not considered as regulatory off-balance sheet items since it is the institutions discretion whether it provides financing, e.g. in the form of a loan, or not, and these uncommitted limits do not establish a legally protected basis for the client’s confidence in receiving financial support. Additionally, the institution would reduce or cancel such uncommitted limits, if the credit standing of the client deteriorates. With regard to committed limits, the nominal amount of the respective off-balance sheet item is determined as the advised limit, unless the unadvised limit is higher. However, this “higher (unadvised) credit limit may be disregarded if its availability is subject to a further credit assessment by the institution, as long as this additional assessment includes a re-rating or a confirmation of the rating of the obligor.” In practice, an on-demand re-rating or an explicit confirmation of the rating of the obligor would be extremely onerous for many customer types and not feasible in a timely manner. This is because many rating methods have a certain amount of manual input (expert judgements) or allow manual overrides. Therefore, we propose to delete the condition “as long as this additional assessment includes a re-rating or a confirmation of the rating of the obligor”. For this credit assessment, it should be sufficient if the institution approves each additional drawing by the obligor on an individual basis by, for example, assessing whether there are indications of deterioration of the obligor’s creditworthiness. This would be in line with the EBA Q&A ID 2017_3246 since the EBA also uses the terms ‘bank’s approval’ and ‘creditworthiness’ and does not require a re-rating or an explicit confirmation of the rating of the obligor: „As an illustration, framework arrangements would not give rise to off-balance sheet items if the institution needs not only to approve the initial and each subsequent drawdown by the client but it has also the complete discretion on whether to give its approval regardless of the fulfilment by the client of the conditions set out in the arrangement, since no drawdown would be possible without a prior and specific approval of the institution.[…]” As outlined above, we believe that this credit assessment prior to each drawdown by the obligor is only required for committed unadvised limits. If such a process exists, these higher committed unadvised limits can be disregarded. We note that ECB was inspired by the definition of ‘commitment’ of the Basel III finalisation accord (§ 78 and footnote 53), definition that has been transposed in the draft CRR3 in article 5 (9). However, none of these definitions require a re-rating of the client or a confirmation of the rating and they are limited to an assessment of the creditworthiness of the client. Consequently, we propose the following amendments to paragraph 195 (underlined): Conversion factor means the ratio of the currently undrawn amount of a commitment that could be drawn and that would therefore be outstanding at default to the currently undrawn amount of the commitment. The extent of the commitment is determined by the advised limit, unless the unadvised limit is higher. The exposure value for the items listed in Article 166(8) of the CRR must be calculated as the committed but undrawn amount multiplied by a CCF. To calculate the exposure value as required by Article 166(8) of the CRR, institutions should adopt the following approach. a) Treat a committed facility as an exposure from the earliest date after acceptance of the client at which the facility is recorded in the institution’s systems in a way that would allow the obligor to make a drawing. An unadvised committed limit is any committed credit limit defined by the institution (i) that is above the committed advised limit the obligor has been informed of by the institution; and (ii) according to which additional drawings are possible, at least temporarily. This higher (unadvised) credit limit may be disregarded if its availability is subject to a further credit assessment by the institution. , as long as this additional assessment includes a re-rating or a confirmation of the rating of the obligor. b) Consider as “commitment” any legally binding contractual arrangement that has been offered by the institution and accepted by the obligor to extend credit, purchase assets or issue credit substitutes. Only commitments qualify as regulatory off-balance sheet items. c) Consider as “conditionally cancellable commitment” any such arrangement that can be and will be cancelled by the institution if the obligor fails to meet conditions set out in the facility documentation, including conditions that must be met by the obligor prior to any initial or subsequent drawdown under the arrangement. d) Consider as “credit lines” all lines including products such as facilities granted for construction where the payments to the obligor are made according to the progress of the construction. Products such as guarantees are not, however, included in the concept of credit lines. e) Facilities which are not qualified as commitments are not in scope for the exposure value calculation, i.e. do not qualify as regulatory off-balance sheet items.	

22	Credit risk	7.4 CCF risk quantification			Amendment	In our view, the requirement in paragraph 204 to first calculate the default weighted average CCF per year of default and then use a simple arithmetic average over these yearly observations can lead to a contradiction to Article 182 (1)(a) CRR, since it could introduce an unjustified weighting of the defaults depending on the year of default. Especially for LDPs, the CCF would become a function of a small number of defaults in each calendar year. Article 182 (1)(a) of CRR clarifies that “institutions shall estimate conversion factors by facility grade or pool on the basis of the average realised conversion factors by facility grade or pool using the default weighted average resulting from all observed defaults within the data sources;” Moreover, this approach would be neither in line with the calculation / aggregation of LRA LGD nor LRA PD and hence introduce a bias. Additionally, the choice of calendar year is fully arbitrary: there is absolutely no economic rationale for taking average from January to December compared to e.g. July to June. We propose to allow institutions to align the calculation of LRA CCFs to LGDs, i.e. consider all individual defaults from the observation period directly in the LRA CCF via a count weighted average. This treatment is consistent to the general alignment between LGD and CCF in terms of exposure (i.e. treatment of drawings after default), level of calculation, etc. As justification for this EGIM interpretation typically Response 6 in the Responses to the public consultation on the draft ECB guide to internal is quoted, namely ""The ECB’s understanding is that Article 182(1)(a) of the CRR does not exclude the interpretation reflected in paragraph 134(c), i.e. the use of the arithmetic average of the yearly averages of realised CCF. The comparison with LGD is also not deemed a valid argument. The rationale for the use of a number-weighted average for LGD is that this parameter captures the losses across the recovery process, which covers multi-year periods"". Although we still disagree to the conceptual view outlined in this response, in this response, yearly average is seen as one, but not the only possible option. We, therefore, propose either to change the approach to overall count-weighted average or include respective clause to allow alternative way of calculating LRA CCF."	
23	Credit risk	8.1 Relevant regulatory references			Amendment	The requirement to assign MoCs at grade level will eventually result in various undesirable consequences: to begin with, a negative incentive towards risk differentiation will follow from this requirement. Ceteris paribus, the number of obligors per grade decreases with an increasing number of grades et vice versa. Therefore, models characterised by a high number of grades and thus a high degree of risk differentiation will be subject to a higher overall category C MoC. Viewed the other way around, reducing the number of grades would be beneficial with regard to the aggregate MoC level, while at the same time problematic with respect to the homogeneity within grades. Moreover, the number of obligors is not evenly distributed across grades. For instance, the highest grades may well contain significantly less obligors than subsequent grades. Hence, grade level MoCs will tend to be higher for higher grades. This will not only lead to a structural bias but potentially even a change in the ranking of obligors. Last but not least, as PD estimation might not be based solely on grade level, grade level MoCs may not be sensible in the first place. In particular since the risk-differentiation model is estimated on segment-level, it only makes sense to quantify MoC A related to that model on segment-level (e.g. for deficiencies such as partly missing risk-drivers). This also applies for deficiencies categorized under MoC B if these apply to the complete segment. The EGIM proposes to base mean-PD estimates per grade solely on long-run default rates and derive MoC C accordingly. In case that a calibrated risk-differentiation model already is a per-client PD estimate based on risk-drivers, this does not make sense from a statistical standpoint. Assume e.g. that PD estimates for risk-differentiation are calculated using a logistic regression model which was calibrated on the long-run sample. A calculation of a mean-PD per grade based on these PD estimates would be far more accurate than the one proposed in EGIM, since information in the risk-drivers to quantify PDs would not be discarded. The EGIM in turn proposes to use client information only to pool clients, and discards of that information for calibration purposes. In practice, grade level MoCs do not allow banks to adhere to the principles of risk differentiation, monotonicity and interpretability at the same time. Therefore, grade level MoCs should not be strictly required. The requirement to consider MoC for deficiencies stemming from any missing or inaccurate climate-related information used in risk estimates, where relevant and material, is deemed unfeasible and impractical given the known limited availability and length of this historical information. Such a focus on climate-related information has no legal basis.	

24	Market risk	6.5 Ratings, probabilities of default and recovery rate assumptions			Amendment	The industry does not believe that the treatment of own credit spread should be changed temporarily at this instance, while the broader revisions linked to implementation of the FRTB are due in 18 months. Subject to the release of the final CRR3, the treatment of own credit in the A-IMA is unclear. The Swedish Presidency “4 columns” documents released in May could be interpreted as requiring the filtering of own credit from the SBM and the DRC in A SA, from the ES, the SSRM and the DRC in A-IMA [AM 2132, 2282b, 2282d]. At the same time, the RTS on back-testing and profit and loss attribution [EBA/RTS/2020/02] requires that own credit is filtered from the actual P&L (APL) and the hypothetical P&L (HPL) where CRR article 33(1) applies, i.e. for liabilities of the institution valued in fair value. At the same time, CRR article 325bg mandates a revision of this RTS, which means further changes, may be coming. Hence, it is not sensible to require the inclusion in the VaR and incremental risk charge (except for migration risk in IRC) of own credit spread. Given the uncertainty around the treatment of own credit in the coming new regulation (CRR3), we believe that the ECB should not be too prescriptive and a flexible approach allowing current practices taken. It will avoid unnecessary implementation burden of short-lived models at a time when banks are striving to get their A-IMA models approved. If the ECB deems that there is a need to take a step towards FRTB at this stage, clarification is required on the transactions referred to in own liabilities, in particular for positions held with trading intent and fair valued through Profit and Loss directly. » In any case, we would like to reiterate that our interpretation of the CRR text hierarchy is that the prudential filters in Article 33 of “Part Two-Own Funds” should come ahead any consideration of the prudential classification (and then any element of capitalization of “Part Three-Capital Requirements). Besides, as the price variation of structured issuances due to own creditworthiness is not measured at fair value through profit and loss for issuances designated in accounting at Fair Value through Profit or Loss under the Fait Value Option (FVO) but is instead included in the Other Comprehensive Income (OCI), the own credit spread risk should not be included in the market risk calculation. With respect to the paragraph 160. the ECB requirement of meaningful differentiation of risk is developed as: a) all annual PDs greater than, or equal to, one basis point AND “increase strictly in line with the decreasing creditworthiness of the obligor” b) PD ratios between adjacent rating grades should be consistent with the observed ratios distribution. In our view, the combination of the requirements above with the available scarce historical data may lead to undesired and unintended consequences, in particular to overconservative and unstable PDs, inconsistent with both historical and market implied data . Hence, we suggest to remove “strictly” in the first threshold and delete the threshold “institutions should calculate the PD ratios between adjacent rating grades and should justify the ratios that can be considered outliers when compared with other ratios or the median of the ratios”.	
25	Counterparty credit risk	5 Modelling of initial margin			Amendment	Cash flows spikes Regarding counterparty credit risk, one of the key elements for EBF members is the treatment of the exposure spikes in margined trading. Indeed, these exposure spikes in margined trading should be part of the Pillar 2 framework as this is currently not part of the CRR and hence not part of the Pillar 1 framework. This should be the case as long as the EU requirements stemming from the Basel standards are not amended to include spikes in Pillar 1. In accordance with Article 104a (1a) of the CRD, any risk not covered by CRR should be covered in Pillar 2. In footnote 63 of the guide (p259), the ECB recognizes that exposure spikes in margined trading are not yet part of the IMM provisions and should therefore not be part of Pillar 1. Consequently, the risk associated with them should be addressed exclusively under Pillar 2.	
26	Counterparty credit risk	11 Effective expected positive exposure			Amendment	Risk not in the EPE The new RNIEPE framework is extremely burdensome. The many approximations performed in CCR models would lead to the monitoring and quantification of a large number of RNIEPE. Because of the very conservative ratio definitions (e.g., impacts floored at netting set level), many minor RNIEPE will require a capital add-on. Indeed, the identification of risks not, or not sufficiently well, captured is already performed in existing processes (e.g., backtesting) and also in supervisory actions (e.g., with alpha increments). We therefore believe that the RNIEPE framework could be deleted or thoroughly revisited Besides, if the RNIEPE framework were to remain, the banking industry is seeking reassurances that the two types of Pillar 1 penalties are not incremental, and that for any Pillar 1 flaw of risks covered by CRR, either an alpha increment or an add-on will apply (but not both at the same time). In other words, the way to treat a CRR-covered Pillar 1 flaw of risks in the model can be either by alpha increment or by add-on, depending on what proves most appropriate for the type of flaw, the scope to which it applies, and the variability of its impact over time. Likewise, no overlap should be possible between a Pillar 1 flaw addressed by (1) an alpha increase or add-on, and (2) a risk that is not (enough) covered by Pillar 1, addressed under Pillar 2.	