EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Template for comments

Public consultation on the revised ECB guide to internal models

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General comments

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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	8.3 Third-party involvement in internal functions and tasks	137 (d)	54	Amendment	In paragraph 137 (d) EGIM, the ECB would like to clarify that third parties that have been involved in the development of rating models or have performed credit risk monitoring unit (CRCU) tasks in the past or that are currently performing these activities may only perform validation tasks for the institution after an appropriate cool-off period has elapsed. In this regard, we would like to note that the requirement in this generality contradicts Article 4 (3) of Delegated Regulation 2022/439 ("RTS on assessment methodology"), according to which, in the case of so-called pooled rating systems, third parties that have been involved in the development of a rating system may support institutions in the validation process by performing validation tasks that require access to the pooled data. In the case of the RSU pool solution, the RSU performs only parts of the validation activities: At the level of the collected pooled data, the risk differentiation and quantification is subjected to intensive quantitative and qualitative tests in order to support the institution's validation on the basis of the more extensive pooled data basis in the best possible way. Within the framework of the pool validation, methods and policies apply which the independent validators of the pool institutes have agreed upon. Also the results of the pool validation are not decided by the RSU, but by a committee consisting of the independent validators of the pool institutes. In this way, the freedom of action at pool level is restricted to a maximum. Moreover, the institutes carry out a fully independent validation on their own which, if necessary, draws on pool results, but which also increasingly stands on its own as the amount of data increases. The RSU has no influence on the results of the institute validation and organizational separation of the validation unit is ensured on the level of the institute. Findings from this institution-specific validation are brought into the pool validation via the above-mentioned validation committee. As a result, the pool validation is only the starting point for the institute's validation, the institute has full control over the validation results. If the regulation were applied literally, external third parties would be forced to organizationally separate those entities that develop rating models for an institution from those that assist the institution in validation. Such a rule would interfere significantly with the business models of the external providers and require them to maintain an organizational separation not found even among the major accounting firms. Moreover, an institution that receives validation support from an external third party cannot realistically ensure that this third party exclusively performs validation actions for its various clients. Especially in low-default portfolios, involvement in development issues (for a different model) can ensure a much stronger practical relevance for the validator. Calculated statistics in these portfolios often give only an incomplete picture, cannot be substantiated by statistical significance statements or ignore relevant correlations between borrowers. The underlying issues can only be learned with sufficient model experience and can only be evaluated correctly by supervising a model in cooperation with the technical contact persons. This is a particular challenge for external third parties. In our opinion, this regulation – taking into account the regulation in Art. 4 (3) of Delegated Regulation 2022/439 ("RTS on assessment methodology") – should therefore not be applied at third party level, but rather only at the level of individual rating models.	In our opinion, the requirement in the last sentence of para. 137 (d) should not apply at the level of a third party, but rather it should only have to be ensured at the level of an individual rating model. Such a regulation interferes massively with business models of third party providers and requires organizational separations that are not even found at the large audit firms. On the other hand, the institutes carry out a fully independent validation on their own. The requirements are therefore too far-reaching against the background that the external third party only performs parts of the validation actions and the responsibility for the validation remains with the institute.	Buchberger, Robert	RSU GmbH & Co. KG	Publish
2	Credit risk	3.6 Use of human judgement	47	75	Deletion	Footnote 34: This also applies to climate-related and environmental risks. Where climate-related and environmental risk drivers are assessed to be relevant and material and the rating system does not include information related to these risk drivers, institutions should consider whether it would be appropriate to take a more conservative approach in the assignment of ratings to the related facilities or obligors by applying an override to the final output of the rating assignment process. We recommend to delete the reference to conservativity: "to take a more conservative approach in the assignment of ratings to the related facilities or obligors by applying". Therefore the corresponding part should be replaced by "to apply".	see G9.	Buchberger, Robert	RSU GmbH & Co. KG	Publish

3	Credit risk	5.1 Structure of PD models	103	94	Deletion	In order to meet the requirement to ensure adequate risk differentiation between classes or pools, institutions shall ensure that there is no material overlap in the distribution of default risk between classes or pools. This is to be ensured by a meaningful differentiation of the default rates of the individual classes. In particular, the ECB expects a very granular rating scale to be used only in cases where the institution is able to empirically confirm the differentiation of risk between classes described in this paragraph (paragraph 103 EGIM). The latter requirement would in effect prevent the use of a differentiated master scale and should therefore be deleted. At the very least, it should be made clear that, where appropriate, evidence at the aggregate level is sufficient and that some degree of interpolation between provable support points is permitted. With a master scale, the identical rating grades with identical default probability are used across all rating systems of the bank. The significance of the individual rating grades is thus the same across all systems, and the processes in the institution can be set up in a uniform manner. Different ranges of the master scale are sometimes necessary for different portfolios with different risk characteristics. Omitting certain levels of the master scale or using differently adapted scales for different models would lead to large and uneconomic leaps, which would strongly influence the acceptance of the rating system. This will be illustrated in the following using three examples: Example 1: Within a rating system, certain ranges of the master scale may not be used at all in the standalone rating model. However, a rating transfer may result in the use of a rating grade not occupied by the standalone model. In this case, the assignment to another rating grade of the master scale would make no economic sense. Example 2: Particularly in the good rating grades, the risk differentiation of individual grades on the basis of defaults is in part not demonstrable, whereas it is readily demonstrable when several grades are aggregated. Omitting rating grades from the master scale would lead to outsized changes in default probabilities in the case of small changes in the input parameters – with corresponding consequences for the stability and acceptance of the rating results (from the analyst's point of view, several rating grades would be skipped each time). The situation is similar with regard to overrides, which would only be possible in certain gradations. Example 3: Certain ranges of the master scale may only be relevant in certain phases of the cycle, because with a fixed master scale and a responsive rating philosophy, customers move across the rating levels over the course of the cycle. Again, the appropriate differentiation cannot be proven at every point in time; omitting rating levels, on the other hand, would lead to absurd leaps.	The newly added paragraph 103 effectively prevents the use of a differentiated master scale and should therefore be deleted: The idea of a master scale is to use identical rating grades with identical probability of default across all rating systems of the bank. The meaning of the individual rating grades is thus identical across all systems and the processes in the institution can be set up consistently. Different ranges of the master scale are sometimes necessary for different portfolios with different risk characteristics. Omitting certain parts of the master scale or using differently adapted scales for different models would lead to large and uneconomic jumps, which would strongly influence the acceptance of the rating system.	Buchberger, Robert	RSU GmbH & Co. KG	Publish

4	Credit risk	5.2 PD risk quantificati on	126	103	Amendment	To assess whether the parameter estimates are biased in accordance with paragraph 38 of this chapter, paragraph 126 of the EGIM requires institutions to compare the LRA default rate with the average PD estimates. In the ECB's view, the estimates are biased if there are (a) material differences between the average of the two measures at the calibration segment level or (b) systematic differences at the class level. In this context, the finding of material differences in (a) or systematic differences in (b) should not be based on statistical significance alone. In particular, in the ECB's view, the lack of statistical evidence that a PD estimate and the corresponding LRA default rate are different based on internal data is not sufficient to conclude that there is no material difference. This is particularly true in cases where only limited data is available. In this regard, we would like to note, as we already did with regard to paragraph 38 EGIM, that a testing procedure that is independent of the statistical significance runs the risk of drawing overly simplistic conclusions. We therefore suggest adapting the requirement to the effect that negative analysis results merely represent a strong indication of bias and should therefore trigger further, valid analyses. Remaining uncertainties can also be addressed by a category B MoC. Especially in portfolios with few defaults, a single default event with closely related borrowers at the institution level may lead to artifacts that could only be cured by economically inappropriate risk differentiation or quantification. If a large number of tests with the same direction are carried out for sub-samples (i.e. for portfolios of institutions) on the basis of a limited database, individual institutions must become conspicuous for statistical reasons alone. On the one hand, such an approach would run counter to the objective of avoiding excessive overfitting in the models (see paragraph 95); on the other hand, it is precisely participation in a data pool that can help in the assessment of relevant issues. Moreover, it would counteract the overarching goal of avoiding RWA differences if such artifacts resulted in unjustified calibration differences across institutions. Such differentiations should therefore only be introduced if there is a sufficient data basis or a thorough root cause analysis.	A test procedure independent of statistical significance bears the risk of simplistic conclusions. We therefore suggest an adjustment in the wording that negative results of the analysis represent a strong indication of bias and should therefore trigger further valid analyses. Remaining uncertainties can also be addressed by a MoC category B. Especially in portfolios with few defaults, a single default event with closely related borrowers at the institution level may lead to artifacts that could only be solved by economically inappropriate risk differentiation or quantification.	Buchberger, Robert	RSU GmbH & Co. KG	Publish