Template for comments

Public consultation on the revised ECB guide to internal models

Institution/Company

Spanish Banking Association (AEB)

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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	1	5	Clarification	We appreciate as usual to have the opportunity to comment on a new revised Guide to Internal Models previous to its definitive approval and subsequent implementation. Being said that, in this occasion we would like to express our surprise on the timing of proposing this review, considering that the current officially proposed implementation date of CRD6/CRR3 and FRTB is January 1st 2025, as the new framework to calculate binding capital requirements. In the case of market risk, as you know, the FRTB changes are radical. In this sense, we would have expected instead to receive for consultation a Guide to Internal Models already adapted to the new capital requirements framework (CRD6/CRR3/FRTB). We appreciate it very much if you can provide clarifications on this.	Avoid undue burden for financial institutions
2	General topics	1.8 General principles on climate-related and environmental risks	25	12	Clarification	According to the proposed ECB's guide, where C&E risks drivers are found to be relevant and material, institutions should include such risk drivers in their internal models for the calculation of own funds requirements, PD and LGDs (even after the date of default and until the date of termination of the recovery process). The ECB guide also proposes to consider C&E risks in the rating systems (allowing to apply an override to the final output of the rating assignment process, if appropriate) and also in the application of a potential MoC (in case of any missing or inaccurate climate-related information considered in risk estimates). Although, the ECB expects institutions to incorporate C&E risks into the risk management process, the explicit incorporation of the C&E risks into the Internal models Guide would result in an uneven playing field between standardized approach banks and internal model institutions. The inclusion of the C&E risks into the standardized rules (CRR) would depend on the final version of EBA's report (and the approach finally taken) on the role of environmental risks in the prudential framework which is expected by the end of the year, so the amendments incorporated in this Guide would be anticipating the EBA's approach (which is pending to be released yet). In addition to this, even if the EBA had published its report on the role of environmental risks in the prudential framework, the Capital Requirements package (CRR and CRD) would need to be amended before any incorporation of C&E considerations in the internal model guide in order to avoid a preferential treatment of standardize banks (vs institutions which calculates RWA according to internal models). Finally, although the internal models (and generally the prudential framework) is risk-based (so its focus would be any potential negative impacts stemming from C&E risks), please bear in mind that the incorporation of C&E considerations, should also incorporate the potential beneficial part of ESG factors.	Avoid misinterpretation of the criteria
3	General topics	2.3 Governance of the roll-out plan for the IRB approach	34	15	Clarification	This paragraph of the General Topics chapter states that "if as the result of a merger or other type of transaction, an entity becomes a parent entity or entity that intends to apply the IRB, the IRB coverage ratio of the post-merger legal entity should meet the expectations set out in paragraph 28(a) of this chapter" (i.e. the initial IRB coverage ratio is expected to be above 50% (in terms of both EAD and RWEAs) at consolidated level). For instance, in the case of the acquisition of an institution using only the STA approach, the IRB coverage of the merged institution might be substantially affected and the 50% threshold might be breached. In a situation like this, it would be materially impossible to return to comply with the expectation in a short period of time in line with the expectation depicted in section 2.7- Internal models in the context of consolidations. For this reason we would like to ask for flexibility regarding expectation when this kind of situations can occur.	Avoid misinterpretation of the criteria

4	General topics	2.3 Governance of the roll-out plan for the IRB approach	34	29,30,	Amendment	The need for the institution to have a percentage of the all exposures classes in IRB has to be rewied in line with the amendments of the CRR3. According to the CRR3, institutions will have to treat all the exposures within an exposure class under IRB if the institution has decided to apply this aproach to such exposure class. CRR3 also sets several cases where the types of exposures within an exposure class can remain under STD. Some of these exceptions are still under discussión, for example, exposures in foreign branches. So, we strongly recomend to review these points to incorporate the CRR 3 new considerations, especially when the CRR 3 and these ECB Guidelines will probabily enter into force at the same time.	To aling with the new regulation (CRR3)
5	General topics	2.6 Reversion to a less sophisticated approach	42	18	Clarification	The concept of “non-negligible reduction of capital requirements” refered in paragraph 42 requires a subjective assessment by each institution that may lead to different interpretations. It would be good if a threshold above which the reduction of capital requirements would be “non-negligible” could be provided.	Avoid misinterpretation of the criteria
6	General topics	2.7 Internal models in the context of consolidations	47	19	Clarification	This paragraph states that par. 37 of the ECB’s Guide on the supervisory approach to consolidation in the banking sector envisages the use of existing internal models in case of consolidations “subject to a clear model mappingand a credible internal models roll-out plan to address the specific internal model issues created through the merger, as well as other conditions where appropriate”. However, although not complemented in this par. 47, par. 37 of the ECB’s Guide on the supervisory approach to consolidation in the banking sector also states that "ECB Banking Supervision acknowledges that there will be a limited period of time in which banks resulting from the business combination might continue to use the internal models that were in place before the merger". In this regard, it would be important to clarify what the ECB considers a “limited period of time”.	Avoid misinterpretation of the criteria
7	Credit risk	2.2 IT systems: infrastructure and implementatio n testing	7	62	Amendment	The requirement of "the institution is able to submit the respective COREP reporting (Article 144(1)(g) of the CRR" by the model extension or change application submission collides with the provision in paragraph 26 of General Topics chapter/ 1.9 section (page 12) of the EGIM where it is stated that :"The ECB generally expects this time frame to be no longer than three months from the date of the notification" of the permission. Moreover, there is a risk that the change request could eventually not be approved by ECB. In such case, undoing the COREP processes to the previous set up would be unduly burdensome for the institution. For this reason, it is proposed an alternative wording, ie. to replace this sentence by "is able to evidence the readiness to implement the respective COREP reporting in a time frame no longer than three months from the date of notification". In the case this is not accepted by the ECB, we look for some flexibility in this requirement. Given the general observed extended timeframe between the submission and the beginning of the IMI, and that, a priori, the future reporting outcome is not being assessed under IMIs, we would like to request some flexibility allowing institutions to provide evidence on the readiness of the reporting system in a second step, after the submission of the model change but no later than the start of the IMI.	To align the General topics and CR chapters as well as not requiring undue bruden to Financial Institutions.
8	Credit risk	3.6 Use of human judgement	46	74	Amendment	The requirement to make different analysts re-rate independently the same obligor generates an undue burden to institutions as it will be extremely complex that the exercise leads to meaningful results. In addition, it constitutes an unrealistic scenario as, generally, there will be an analyst that posseses a deep knowledge of the obligor. This knowledge will be crucial to properly rate the obligor considering human judgement and cannot be matched by an alternative analyst. Instead, the requirement should be substituted by the need to establish clear guidelines and instructions that limit the discretion of the analysts when applying human judgement. In such a way the generation of the rating can be traceable, but on the premise that there is an analyst with a deep knowledge of the obligor behind the generation of the rating.	Avoid undue burden for financial institutions
9	Credit risk	3.7 Use of data in the case of consolidations	54-57	78	Clarification	We appreciate very much that the ECB has incorporated expectations regarding consolidations of institutions. Nevertheless, it seems that the new expectations are focused only on the modelling aspects of the IRB models and the integration of the data within the models as well as the application of the necessary adjustments. We would also recommend that the EGIM incorporate expectations in terms of a flexible process for aligning the DoD to be used after a consolidation process, since for management purposes this aspect is key. Flexibility aligned to management needs in combination of a properly defined RTC should be advisable.	Avoid misinterpretation of the criteria
10	Credit risk	4.2 Consistency of the application	62	79	Amendment	Taking into account that the consistent identification of the default of the obligor application is usually limited to global portfolios as per the materiality of common obligors among different jurisdictions and subsidiaries (other portfolios may be exempted of this requirement - para. 81 and 82 of the EBA Guidelines on DoD); the approach to assess the credit quality of global clients has been to evaluate its overall status through the aggregation of all the unpaid balances and exposure converted into a single currency (euro) applying the ECB materiality thresholds (500 € absolute threshold and 1% relative threshold). Our understanding is that for cases where a global client has some exposure in jurisdictions where national authorities have set a different threshold, carrying out a parallel counting of days past due limited to the portion of the exposure within that jurisdiction, would not allow for an accurate assessment of the credit quality of the obligor (e.g. if a client holds 95% of its exposure in a jurisdiction falling under SSM threshold and 5% under other national regulation, the default may be triggered even if in overall terms is not material). It should also be noted that, applying this parallel counting of days past due is excesively burdensome in terms of processes specially in cases where most of the exposure of the client is booked in a ECB jurisdiction.	Avoid the application of an inconsistent criteria for global clients and undue burden for financial institutions

11	Credit risk	4.2 Consistency of the application	63	79	Clarification	According to paragraph 63 it could be understood that the treatment of non-retail must be the same as for retail, but the EBA clarifies in the Q&A (https://www.eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2018_4431) that it should be up to institutions to specify the treatment of joint credit obligations other than retail and for default contagion between exposures in their internal policies and procedures. So we ask for clarification on the contradiction between the guidance and the EBA.	Avoid misinterpretation of the criteria
12	Credit risk	4.3 Days past due criterion	69	81	Amendment	Applying the exchange rate quoted every day when the materiality threshold and the relevant amounts are expressed in different currencies would introduce high volatility and hinder the efficient management of unpaid exposures. A viable option would be to apply the monthly exchange rate	Avoid volatility in the absolute threshold and undue burden for financial institutions
13	Credit risk	4.3 Days past due criterion	76	82	Amendment	It should be considered that in those cases where a lower materiality threshold is set, this threshold is used to measure the days past due of the exposure or client working as an objective default indicator instead of an indicator of unlikeliness to pay as the unpaid amount exceeding this limit is deemed material	Avoid misinterpretation of the criteria
14	Credit risk	4.7 Adjustments to risk estimates in the case of changes to the definition of default	92	88	Clarification	The paragraph specifies that the correction factors should be based on an RDS that covers at least two years of data adjusted at granular level by means of a retrospective simulation, parallel run or similar classification of data according to the new definition of default. Please, specify how to proceed when the entity is not able reach the two years of data using the proposed alternatives (e.g. due to the application of a new UTP). For this reason, we firmly believe that the ECB should contemplate the possibility to use proxies when this expectation cannot be met.	Avoid misinterpretation of the criteria
15	Credit risk	4.7 Adjustments to risk estimates in the case of changes to the definition of default	93	89	Amendment	The systematic addition of a MoC triggered by modifications in the definition of default seems excesively restrictive and may limit the introduction of new changes in the definition of default as it would penalise model outcomes.	Avoid undue burden for financial institutions
16	Credit risk	5.2 PD risk quantification	130	105	Deletion	Taking into account the length of the usual historical observation periods employed to estimate regulatory PDs, the need to reproduce the method to assign exposures to grades or pools to cover the whole period generates a requirement almost impossible to meet in most portfolios. The requirement is an over-interpretation of the premises in the EBA/GL/2017/16, which consider acceptable ways to estimate regulatory PDs where such data requirement is not needed. It is expected that institutions should keep evolving their risk-ranking methods in order to consider the most relevant information to rate their exposures, especially in a fast-evolving and dynamic environment. Expecting that this evolving information will be available at all periods is not realistic and may end up generating a considerable burden to institutions when aiming to relate different risk-ranking methods employed over time (or, alternatively, substantial MoCs that may end up distorting the level of estimates). If the option were to build ranking methods applicable at all times, this would result in poor discrimination methods with little use for managemente purposes, as no new information could be incorporated into ranking methods. The requirement should be relaxed.	Strict interpretation of regulatory requirements in EBA/GL/2017/16
17	Credit risk	5.2 PD risk quantification	132	106	Clarification	It should be clarified the expectations around the required comparison. In particular, whether circumstances where both metrics are similar but the time series of the PD at calibration segment level exhibits cyclical variation are deemed as appropriate.	To avoid any misinterpretations regarding the supervisory expectation.

18	Credit risk	5.2 PD risk quantification	136	108	Clarification	The previous paragraphs in the section tend to point out towards prescribing a grade level approach, although in a much more restrictive view than that described in the EBA/GL/2017/16 (see Table 1 in the Background and Rationale section), as it is practically required to reproduce the grading structure in the whole historical observation period (disregarding simpler and more pragmatic options which may fit in the condition 'Adjust PD on rating grade level to LRA DR' stated in the GLs). If a calibration at segment level approach is employed, the expectation in the ECB Guide is that the results would be similar (disregarding then the range of alternative options described in the mentioned Table 1 under portfolio level approaches). Under the usual rating philosophy of risk-ranking methods employed by institutions to assign exposures to grades or pools (i.e., scoring and rating models based on the internal information of the exposures), the likely outcome of such an approach would be cyclical RWA calculations, by which it would be highly complex to meet the requirement of CDR 2022/439 in that 'With regard to risk quantification, it is desirable that the PD estimates are relatively stable over time in order to avoid the excessive cyclicality of own funds requirements'. In order words, any meaningful risk differentiation system will combine drivers predictive in the short and the long-run, thus generating scores/rating relatively sensitive to economic conditions. When taking into account the natural decision to use such ranking models to assign exposures to grades or pools, the prescribed methodology will result in cyclical RWA calculations (just varying depending on the rating philosophy of the institution) and thus significantly narrowing the range of options considered acceptable in the EBA GLs. However, a last requirement seems to exist in this paragraph forcing institutions to 'compare the average PD (before MoC) at calibration segment level with the one-year default rate and with the LRA default rate at calibration segment level for each of the calculation dates adopted for LRA default rate calculation'. Then it is required to judge whether the results are 'appropriate' on the basis of that comparison. How should the term 'appropriate' be understood? If the rating philosophy is somewhat cyclical, the comparison will evidence that the mentioned average PD is cyclical; that is, this would be the expected result. Is that expected result 'appropriate'? Instead, is the paragraph suggesting that an adjustment to the LRA DR should be made (i,e, an extreme version of a trhough the cycle calibration philosophy)? The expectations in this paragraph should be clarified, as otherwise the expectations of the whole methodological framework seem extremely confusing, apart from the excessive complexities imposed to first come up with the PD estimates.	To avoid any misinterpretations regarding the supervisory expectation.
19	Credit risk	6.1 Realised LGD	154	117	Clarification	The meaning of the term 'significant' should be narrowed, as otherwise it may lead to different interpretations.	To avoid any misinterpretations regarding the supervisory expectation.
20	Credit risk	6.1 Realised LGD	155	117	Clarification	The paragraph 500 mentions the adjustment will be only possible until 28/6/2022 but it is supposed that the CRR III agreement will allow to apply it until June 2024, so the question is if this guideline will be mandatory when the CRR III entry into force how can we manage the extended period into the CRR III with the guideline.	Avoid misinterpretation of the criteria
21	Credit risk	6.1 Realised LGD	166	120	Deletion	Massive disposals should be disregarded from the calculation of the maximum recovery period. In the end, the recovery of such cases is projected, considering implicity the possibility of obtaining flows in the future. If the affected facilities are maintained in order to calculate the maximum recovery period there is an intrinsic contradiction with the assumption used to obtain the flows. If disposals are significant, they would bias the calculation or generate disruptive effects in any relevant time series. At most, representativeness analyses could be required (for instance, if the massive disposals just applied to long-time-in-default facilities).	
22	Credit risk	6.1 Realised LGD	173	121	Amendment	The use of out-of-sample and out-of-time samples should be restricted to cases where there is a risk of overfitting, for instance when building risk differentiation methods combining several variables with scoring-like techniques. However, in many instances, just a few drivers are combined and the number of pools is very reduced in this parameter. Furthermore, there may be cases where the risk differentiation process should be performed with a reduced sample (in some obligor level portfolios). On these grounds, the consideration of such samples adds no value and may lead to less robust risk differentiation processes.	To avoid imposing a requirement which in some circumstances adds no value to the model
23	Credit risk	6.4 Estimation of ELBE and LGD in-default	192	131	Amendment	The interpretation of the EBA/GL/2017/06 seems too restrictive, in that a too 'long-run view' of the ELBE parameter is prescribed. The description in the paragraph is likely to result in significant differences between the estimated parameter and 'the best estimate of the expected loss given current economic circumstances'. Furthermore, it may be the case that the ELBE significantly deviates from the specific credit risk adjustment associated to the exposure, disregarding the general expectation of certain alignment between the concepts (once factors like the discount factor are taken into account). On these grounds, it is suggested to modify the paragraph in order to not distort the nature of ELBE parameter.	Ammendment to avoid distortion on the interpretation of the regulatory concept
24	Credit risk	7.3 CCF structure	202	136	Amendment	The use of out-of-sample and out-of-time samples should be restricted to cases where there is a risk of overfitting, for instance when building risk differentiation methods combining several variables with scoring-like techniques. However, in many instances, just a few drivers are combined and the number of pools is very reduced. Furthermore, there may be cases where the risk-differentiation should be performed with a reduced sample (in some obligor level portfolios). On these grounds, the consideration of such samples adds no value and may lead to less robust risk differentiation processes.	To avoid imposing a requirement which in some circumstances adds no value to the model
25	Credit risk	7.4 CCF risk quantification	204	138	Deletion	The requirement to compute the average realised CCF 'as the arithmetic average of the yearly averages of realised CCFs in that period' represents an override of article 182 (1) (a) of the CRR, which clearly requires 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'. Please note that this description in the CRR is exactly the same as for the LGD parameter, for which the Guide is not prescribing any 'yearly averages' calculation.	Contradiction with higher-level regulatory reference

26	Credit risk	8 Model-related MoC	210	141	Amendment	The requirement to calculate the MoC at grade level represents an over-interpretation of the EBA/GL/2017/16, especially when the LRA DR is calculated at calibration segment level. It may even create perverse incentives, in that more discriminant rating systems will be penalised against those presenting poor discrimination. It may also result in disproportionate levels of conservatism in cases where the volume of defaults is not significant. The new text added to the paragraph does not contribute to the understanding of an already confusing requirement. In particular, it seems difficult to understand how MoCs at calibration segment level and at grade level can be similar if the underlying number of observations will be entirely different (as detailed in the expectation set in a) of this same paragraph).	Ammendment to avoid distortion on the interpretation of the regulatory concept
27	Counterparty credit risk	3.2 Principles for ECB Banking Supervision	24	226	Clarification	Please clarify whether when including collateral-in-transit in the MPOR modeling in the following statement "...This understanding implies that the default time is not necessarily immediately at the start of the MPOR but could occur at a later point in time" entails extending the end of the MPOR in a backward modelling that period (eg. 1 or 2 more business days)	To avoid any misinterpretations regarding the supervisory expectation.
28	Market risk	2.2 Delimitation of the regulatory trading book	10	149/150	Clarification	With the sentence "The ECB considers that this also applies to CVA hedges for counterparties which are exempted from the own funds requirement for CVA risk in accordance with Article 382(4) of the CRR.", we understand that CVA hedges for exempted counterparties from CVA ofrs are exempted of IMA ofrs for specific risk and only should be included for IMA ofrs related to general risk (in line with EBA Q&A question 2013_402 about article 386 CRR regulation)	To avoid any misinterpretations regarding the supervisory expectation.
29	Market risk	2.6 Treatment of specific positions	31	157	Clarification	We appreciate clarification on the new sentence which has been added at the end of this paragraph: "…the ECB understands that the funding risk embedded in own liabilities held in the trading book should be modelled in the IMA". Does this mean that the "liquidity value adjusment (LVA)" is under IMA scope? As there is not a common benchmark in the industry on the LVA treatment, this could generate not desirable differences among banks	To avoid any misinterpretations regarding the supervisory expectation.
30	Market risk	6.5 Ratings, probabilities of default and recovery rate assumptions	158	197	Clarification	• Are the reference to “estimates of PDs derived in combination with Market prices” understood as spread implicit PDs? • What does it mean the reference to “relevant corrections made to obtain real-world PDs”? • If IRBA or external PDs (derived from real historic data) are used for IRC calculations, would be necessary to perform the article’s mentioned analysis?	To avoid any misinterpretations regarding the supervisory expectation.
31	Market risk	6.5 Ratings, probabilities of default and recovery rate assumptions	159	198	Clarification	If for a particular sector the entity has no IRBA PD model approved, no real data is available to calibrate PDs for a range of rating grades (e.g. sovereign issuers if rated BBB or above) and no external PDs are available: • How would it be possible to calibrate a “conceptually sound” PD model which produces PDs “accurate and consistent across all rating grades”? • As the hypothetical calibrated model would be based on no real data, would not be extremely weak and not fit for the purpose of being used within a regulatory capital calculation? If for a particular sector the entity has no IRBA PD model approved, no real data is available to calibrate PDs for a range of rating grades (e.g. sovereign issuers if rated BBB or above) and no external PDs are available: • How would it be possible to calibrate a “conceptually sound” PD model which produces PDs “accurate and consistent across all rating grades”? • As the hypothetical calibrated model would be based on no real data, would not be extremely weak and not fit for the purpose of being used within a regulatory capital calculation?	To avoid any misinterpretations regarding the supervisory expectation.
32	Market risk	6.5 Ratings, probabilities of default and recovery rate assumptions	160	198	Clarification	• What would be the thresholds or criteria to be considered as an outlier? If the PDs obtained according to the applicable calibration model are lower than one basis point for a range of adjacent rating grades (e.g. from AAA to A) but they increase in line with the decreasing creditworthiness: • If these PDs are floored to one basis point for a range of adjacent rating grades as required by this article ¿is the strict increase being satisfied? • Would the ratios performed among the floored PDs for a range of adjacent rating grades be useful or should be discarded from the computation of outliers? Considering that external PDs are allowed for being used within IRC calculations, as gathered in the “EBA Guidelines on the IRC (EBA/GL/2012/3) 12. Source of PDs and LGDs: 4” and they are based on real observed default data: • What would the supervisor’s expectations regarding ratios when there are outliers or when they do not increase strictly in line with the decreasing worthiness? Should some transformation/interpolation be implemented even if the real default data shows a different situation?	To avoid any misinterpretations regarding the supervisory expectation.
33	Market risk	6.5 Ratings, probabilities of default and recovery rate assumptions	161	198	Clarification	• Which particular PDs are alluded to when referring to “PDs used to account for expected losses”? • If IRBA PDs are used, as mandated in the “EBA Guidelines on the IRC (EBA/GL/2012/3) 12. Source of PDs and LGDs: 1”, is it necessary to perform additional analysis and documentation to the ones already considered within the calibration?	To avoid any misinterpretations regarding the supervisory expectation.