EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Template for comments

Public consultation on the ECB guide to internal models – risk-type-specific chapters

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General comments

Template for comments

Public consultation on the ECB guide to internal models – risk-type-specific chapters

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: 07 November 2018

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	Credit Risk	3.7 Use of human judgement	46	19	Amendment	While ideally more observations should lead to less dependence on the use of human judgement, but this is usually limited to ceteris paribus circumstances, or when both internal and external factors are changing only marginally. Applying the proportiality criteria across dimensions such as jurisdictions/time/asset classes creates a heavy burden that can cannot be easily overcomed, while its overall added value is likely to be limited. A better formulation of the requirement could be that besides appropriately managing the human judgements the use of them should be justified (as a minimum criteria).	Regulation allows considerable freedom in choosing quantitative methods for risk differentation to achieve compliance with requirements. As human judgement complements the choice of quantitative methods, it is also not to be subject to limits such as proportionality to number of available observations..	Rudorfer, Franz	Austrian Federal Economic Chamber - Division Bank and Insurance	Publish
2	Credit Risk		52	21	Clarification	While it seems logical, the requirement of adequate performance for all economically significant and material sub-ranges of a PD model can be excessive without additional clarification. The underlying methods for the model are able to ensure that it performs well on its range of application, but just on average for a given scoring or calibration method. If a portfolio is to be divided along several dimensions to check the consistency and adequateness of the model's performance, then there almost always will be such sub-ranges which underperform, even materially from scoring or calibration point of view. To mitigate this the institutions have basically two choices: either to enhance the performance of the underperforming sub-range while keeping the structure of the rating system unchanged, which immediately brings up the topic of overfitting; or to re-define segments (both for scoring and calibration) based on the identified sub-ranges. The latter solution might also to be avoided, as this clearly points to the direction on reducing flexibility in internal segmentation (both for risk differentiation and risk quantification) practices, which the EBA text indirectly recognizes as a feature that is to be preserved for the IRB approach. Therefore additional clarification on the economic significance and materiality of sub-segments would be helpful to guide the understanding, especially its relationship to internal segmentation practices (both for risk differentiation and risk quantification).	Maintaining adequate performance on all economically significant and material sub-ranges creates unnecessarily heavy burden without proper understanding of their meaning and promotes regulation-driven segmentation against segmentation driven by internal risk assessment.	Rudorfer, Franz	Austrian Federal Economic Chamber - Division Bank and Insurance	Publish
3	Credit Risk	4.1 Structure of PD models	53	22	Clarification	Clarification is needed on why is it considered necessary to provide documentation on the considered but not used risk drivers for assessing the appropriateness of obligor/transaction assignment.	Providing documentation on the unused risk drivers is not a necessary condition to assess the appropriateness of multiple rating system.	Rudorfer, Franz	Austrian Federal Economic Chamber - Division Bank and Insurance	Publish
4	Credit Risk	4.1 Structure of PD models	55	22	Amendment	The insitutions should be allowed to assess the severance and materiality of the deviation from the targeted level of the defined metrics (together with its tolerance level) as that should drive its efforts for remedy actions. Otherwise the proposed setup is running the risk that quantity will be preferred over quality when deciding on prioritization of remedy actions. Also it could necessitate actions in case of type I errors (false negative signals).	Although explicit metrics are a very efficient tool for initial/ongoing performance evaluation for risk differentiation, but rectification of deviations should also be driven by assessment, which is excluded by the requirement.	Rudorfer, Franz	Austrian Federal Economic Chamber - Division Bank and Insurance	Publish
5	Credit Risk	4.1 Structure of PD models	57	23	Clarification	It shall be clarified that the concept of masterscales are not endangered by this paragraph and especially by point c). Masterscales are important tools for internal governance ensuring comparability and measures across regions and rating models. It allows for efficient IT implementation and internal and external reporting. It should be clarified that adressing the issue of 'too few observations' is best practice during validation and not by adjusting grades in the rating assignment process.		Rudorfer, Franz	Austrian Federal Economic Chamber - Division Bank and Insurance	Publish
6	Credit Risk	4.1 Structure of PD models	58	23	Clarification	Clarification would be needed on how the reasonably similar default risk within a grade is understood. As currently institutions have flexibility on defining both the number of grades and the accompanied thresholds, it can be a case that a grade is defined as a PD range of 7% to 11%. Can facilities be understood as having reasonably similar default risk if they belong to this PD range?	As institutions have flexibility in defining both the number of grades and the accompanied PD ranges (if the minimum criteria is met); the requirement on reasonably similar default rate needs to be better explained.	Rudorfer, Franz	Austrian Federal Economic Chamber - Division Bank and Insurance	Publish

7	Credit Risk	4.1 Structure of PD models	58	23	Amendment	In our understanding it should be avoided that (even strong) disagreement between the existing model and an alternative one (where the latter uses additional risk drivers or a different discretization of the existing ones) should be automatically considered as indicator for lack of homogeneity within a grade/pool. Ranking of obligors/facilities by different scoring methods models is unlikely to be identical, and as the calibration should not change the ranking order of the obligors/facilities the original differences are likely to be transmitted to the grades. This way, significantly different default rates might be identified within a grade if the original assignment is evaluated against an alternative method. Overall, it is very likely that for every model there is an alternative model which outperforms the original one in terms of discrimination power for a certain grade, while the original model performs better on its full range of application.	The existence of one alternatively ranking model should not be seen as enough evidence against homogeneity of a rating grade	Rudorfer, Franz	Austrian Federal Economic Chamber - Division Bank and Insurance	Publish
8	Credit Risk	4.1 Structure of PD models	61	24	Clarification	Clarification is needed whether the requirement on the appropriate balance is to be understood as balancing the impact of short-term and long-term drivers, or is it targeting the avoidance of extreme setups (for example overwhelmingly short-term risk drivers)	The requirement of inclusion of all information together with balancing risk drivers between short-term and long term orientation is potentially in conflict if the requirement is targeting appropriateness instead of avoiding extreme cases.	Rudorfer, Franz	Austrian Federal Economic Chamber - Division Bank and Insurance	Publish
9	Credit Risk	4.1 Structure of PD models	61	24	Amendment	This requirement is potentially overly excessive. While it could be reasonable to set a requirement that a model's performance is not abruptly breaking down in case of applying a longer time horizon for default recognition, it might be better to avoid exact definition of time horizon (especially as paragraph 55a is understood to be also applicable for it definition and monitoring of metrics for default horizon of 2-3 years) and listed as a good practice that is supported by ECB.	By adding a secondary measure (longer time horizon of 2-3 years for default recognition) against which the performance of models is to be assessed it needs to be clarified what constitutes as good practice in case of conflict between the targets (one-year PD vs multiple-year PD).	Rudorfer, Franz	Austrian Federal Economic Chamber - Division Bank and Insurance	Publish
10	Credit Risk	4.1 Structure of PD models	61	24	Amendment	Amendment would be needed as the assignment process already needs to have appropriate performance to provide meaningful assessment of the risk, so while the requirement can be a good direction it should not be absolutized. The likely ways to provide evidence on performance under different economic conditions is by either lengthening the time-span of samples used for calibration to experience more variation in economic conditions or to develop models that are applied in multiple countries where different conditions are present. In the absence of enough data to apply the former approach the latter direction might be the go-to solution, which might be unwanted from regulatory perspective, especially considering its relation to paragraph 52.	Amendment would be needed to avoid unwanted side effects of the requirement	Rudorfer, Franz	Austrian Federal Economic Chamber - Division Bank and Insurance	Publish
11	Credit Risk	7 Model-related MoC	142	61	Amendment	Clarification needed, that whether is it understood correctly that 'each year's default rate' is in fact the averaged one-year default rate, that can be calculated from overlapping one-year time windows as also stated in the same paragraph.	The used term 'each year's default rate' has a materially different meaning than the assumed 'one-year default rate' as the former refers to calendar years. Unchanged text might trigger different understanding of requirements and is potentially in conflict with the referred EBA text.	Rudorfer, Franz	Austrian Federal Economic Chamber - Division Bank and Insurance	Publish