Template for comments

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

<table>
<thead>
<tr>
<th>Institution/Company</th>
<th>German Banking Industry Committee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contact person</td>
<td>Mr/Ms</td>
</tr>
<tr>
<td></td>
<td>Mr</td>
</tr>
<tr>
<td>First name</td>
<td>Silvio</td>
</tr>
<tr>
<td>Surname</td>
<td>Andrae</td>
</tr>
<tr>
<td>Email address</td>
<td><a href="mailto:silvio.andrae@dsgv.de">silvio.andrae@dsgv.de</a></td>
</tr>
<tr>
<td>Telephone number</td>
<td>4930202255437</td>
</tr>
</tbody>
</table>

☐ Please tick here if you do not wish your personal data to be published.

General comments
<table>
<thead>
<tr>
<th>ID</th>
<th>Chapter</th>
<th>Section</th>
<th>Paragraph</th>
<th>Page</th>
<th>Type of comment</th>
<th>Detailed comment</th>
<th>Concise statement as to why your comment should be incorporated</th>
<th>Name of commenter</th>
<th>Institution</th>
<th>Personal data</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Credit Risk</td>
<td>2</td>
<td>Data maintenance for the IRB approach</td>
<td>13a), 17, 18</td>
<td>Clarification</td>
<td>The requirements for data quality setting go beyond the requirements of the EBA Guideline on PD Estimation and the RTS on Asessment Methodology regarding the IRB approach. In particular, it should be made clear that it is not absolutely necessary to establish an independent, dedicated unit for setting data quality.</td>
<td>You indicate whether your comment is a proposed amendment, clarification or deletion.</td>
<td>Andrae, Silvio</td>
<td>German Banking Industry Committee</td>
<td>Fränklich</td>
</tr>
<tr>
<td>2</td>
<td>Credit Risk</td>
<td>3.4</td>
<td>Use of pooled data</td>
<td>40</td>
<td>Amendment</td>
<td>In order to avoid bias in risk parameter estimates, multi-rated counterparties should also be counted consistently in the numerator and denominator of the default rate in pooled analysis. The procedure for assessing that the pool used as a basis for developing and reviewing the pool model is structurally matched as well as possible to the portfolios of the individual institutions that use the pool model for valuing their relevant portfolio and, in particular, that large counterparties are adequately included in the data pool.</td>
<td>Paragraph IV of the Credit Risk chapter sets out a concrete requirement for pool solutions for dealing with clients for which ratings are prepared by more than one of the institutions participating in the pool (common obligors). A requirement is that the existence of such common obligors may be reflected in distortions or double-counting for risk parameter estimates. This requirement is then further expanded on by requiring in particular that each common obligor is only taken into account once in the calculation of the one-year default rate. We consider this requirement to be inappropriate, in particular because the exclusion of multi-rated counterparties in the sense of the “single count only” requirement here would be lead to bias in many portfolios in the scope of the vast majority of rating systems (e.g. all rating systems in the RSU (pool solution)) includes clients of different company sizes (e.g. in the sense of different ranges of total assets or revenues). However, the frequency of common obligors, i.e. counterparties within the data pool that are rated by more than one institution, is directly related to the size of the company, for example: large counterparties (e.g. DAX groups) usually have relationships with more than one credit institution much more often than smaller counterparties (e.g. small medium-sized companies). Excluding multi-rated counterparties, therefore, leads to a structural change in the resulting “pool without double-counting” due to the less frequent occurrence of common obligor scenarios, the smaller counterparty scenarios are now significantly underrepresented, not only is it impossible to counter the “pooling double-counting”, but also it is impossible for the pool of the individual institutions participating in the pool. The structure of the “pool without double counting” thus differs to a greater extent from the pool of the individual institutions. The establishment of a separate, independent unit for data quality management would lead to a disproportionately high level of effort and is therefore not necessary for ensuring independent data setting.</td>
<td>Andrae, Silvio</td>
<td>German Banking Industry Committee</td>
<td>Fränklich</td>
</tr>
<tr>
<td>3</td>
<td>Credit Risk</td>
<td>3</td>
<td>Data requirements</td>
<td>42(c)</td>
<td>Amendment</td>
<td>Institutions using a pool model should not be required to have an aligned process for managing disallowed debts.</td>
<td>From our point of view, this requirement constitutes inadmissible interference with the business practice of the institutions and has no basis in supervisory law. In addition, the purpose of this requirement is in any case not apparent with regard to the estimation of PD.</td>
<td>Andrae, Silvio</td>
<td>German Banking Industry Committee</td>
<td>Fränklich</td>
</tr>
<tr>
<td>4</td>
<td>Credit Risk</td>
<td>4</td>
<td>Probability of default</td>
<td>52</td>
<td>Amendment</td>
<td>The rejection of models separately for individual sub-portfolios would be very time-consuming. The external validation, for example, an analysis based on geographical regions would be fund incoherent in the case of globally active institutions and has no basis in supervisory law. In this respect, it is not possible to determine whether a single institution participating in the pool will have enough comparable data to perform the required stress tests.</td>
<td>The rejection of models separately for individual sub-portfolios would be very time-consuming. The external validation, for example, an analysis based on geographical regions would be fund incoherent in the case of globally active institutions and has no basis in supervisory law. In this respect, it is not possible to determine whether a single institution participating in the pool will have enough comparable data to perform the required stress tests.</td>
<td>Andrae, Silvio</td>
<td>German Banking Industry Committee</td>
<td>Fränklich</td>
</tr>
<tr>
<td>5</td>
<td>Credit Risk</td>
<td>4</td>
<td>Probability of default</td>
<td>76(b)</td>
<td>Amendment</td>
<td>The preference given to using overlapping 1-year time windows over non-overlapping time windows for certain analysis results, in particular in the case of 76(b) for the significant difference of the observed average default rate between overlapping and non-overlapping time windows is not appropriate without further clarification of the cause of the difference.</td>
<td>The preference given to using overlapping 1-year time windows over non-overlapping time windows for certain analysis results, in particular in the case of 76(b) for the significant difference of the observed average default rate between overlapping and non-overlapping time windows is not appropriate without further clarification of the cause of the difference.</td>
<td>Andrae, Silvio</td>
<td>German Banking Industry Committee</td>
<td>Fränklich</td>
</tr>
<tr>
<td>6</td>
<td>Credit Risk</td>
<td>4</td>
<td>Probability of default</td>
<td>80</td>
<td>Clarity</td>
<td>The proposed granularity does not currently result from supervisory requirements and would lead to a very high validation effect with questionable added value.</td>
<td>The proposed granularity does not currently result from supervisory requirements and would lead to a very high validation effect with questionable added value.</td>
<td>Andrae, Silvio</td>
<td>German Banking Industry Committee</td>
<td>Fränklich</td>
</tr>
<tr>
<td>7</td>
<td>Credit Risk</td>
<td>4</td>
<td>Probability of default</td>
<td>85</td>
<td>Amendment</td>
<td>For example, if different average default rates are the result of a different risk structure of the portfolios internally versus the rest of the pool, but the risk drivers of the model reflect this risk structure sufficiently well (e.g. internal PD measure vs. the rest of the pool is also correspondingly different), then no MoC should be required.</td>
<td>For example, if different average default rates are the result of a different risk structure of the portfolios internally versus the rest of the pool, but the risk drivers of the model reflect this risk structure sufficiently well (e.g. internal PD measure vs. the rest of the pool is also correspondingly different), then no MoC should be required.</td>
<td>Andrae, Silvio</td>
<td>German Banking Industry Committee</td>
<td>Fränklich</td>
</tr>
</tbody>
</table>
Paragraph 80 sets out a special requirement within the context of the requirements for calculating the long-term default rate in the event that an institution also uses calculations based on pool data in addition to its internal data. Specifically, there is a requirement that the calculation of the default rate at pool level in the case should be carried out separately from the calculation of the default rate at the institution level.

Excluding data from an institution would be completely alien in the conceptual framework for pool models. One of the key aspects of the pool model approach is the development and calibration of the model at the level of the entire pool. This enables institutions to access models that are more differentiated, accurate and stable in their application to the portfolios of an individual institution than any model that could be developed on the basis of the portfolio of an individual institution. The pivotal point here is the data pool as a whole. An institution-specific “pool without the institution” resulting from the artificial exclusion of the data of an individual institution cannot in any way be meaningful in its optimising or reviewing the pool model.

Quite apart from this, a “pool without the institution” perspective does not offer any added value for model validation areas for the individual institution. If the amount of the institution is too small compared with the size of the data pool the comparison with the “pool without the institution” does not lead to any other outcomes than the comparison with the pool as a whole. On the other hand, if the share of the individual institution’s data in the pool is large, the “pool without the institution” no longer represents a meaningful benchmark for the institution because the model is not optimised, calibrated or validated based on this data pool.

In our opinion, it is neither effective nor appropriate to determine representativeness based on non-relevant dimensions. If a dimension demonstrably has no influence whatsoever on credit risk, it is also irrelevant for representativeness. Requiring evidence of representativeness is an unnecessary effort because the evidence does not pursue any objective and is hence obsolete.

Requiring evidence of representativeness is unnecessary because the evidence does not pursue any objective and is hence obsolete. If a dimension demonstrably has no influence whatsoever on credit risk, it is also irrelevant for representativeness. The evidence does not pursue any objective and is hence obsolete. It is neither effective nor appropriate to determine representativeness based on non-relevant dimensions. If a dimension demonstrably has no influence whatsoever on credit risk, it is also irrelevant for representativeness.

In order to be able to determine an appropriate estimate of the losses still to be expected, institutions must in particular be permitted to take other criteria into account (such as existing characteristics with regard to the institution’s own recovery processes as well as the duration of the default, the processing status, the unit in charge, the occurrence of co-defaults, the liquidity of the recovery process). In addition, it is necessary to clarify what is meant by a “separate” calculation. In particular, it is necessary to clarify that, for the calculation of pool level, there is no requirement to artificially evaluate the data of the relevant institution from the data pool.

### Credit Risk 5.3 Risk quantification

#### Paragraphs 44-45

The (a) to (e) list in this paragraph represents alternative approaches for identifying the maximum “time-to-workout”.

- Paragraph 113(a) proposes two options for aggregating the realised LGDs weighted by the number of defaults. In our view, the volume-weighted aggregation of the facilities at client level is the more appropriate approach, since it is not clear what the added value is of performing all of these analyses. For example, alternative determination methods can be used to validate the results. However, the choice of the method to be used should be a matter for the institutions in order to ensure methodological freedom.

#### Paragraphs 46

In particular for portfolios with potentially very long recovery periods (e.g. loans secured by real estate in which there is also an extremely high variability in the recovery periods (e.g. clarification through curing or liquidation by private sale, compulsory auction, dependence on available capacity of local courts and demand at compulsory auction date), we are highly critical of the proposal to base the analysis of defaults exclusively on a given year (vintage), which we regard as inappropriate.

In order to be able to determine an appropriate estimate of the losses still to be expected, institutions must in particular be permitted to take other criteria into account (such as existing characteristics with regard to the institution’s own recovery processes as well as the duration of the default, the processing status, the unit in charge, the status of recovery, etc.). Restricting modelling freedom at this point by limiting it solely to completed defaults in a given year for which a similar LGD could be observed at a given time, leads here to distorted results that do not allow for a meaningful role in optimising or reviewing the pool model.

In addition, it is possible that this approach cannot ensure the availability of a sufficient number of observations.

#### Example

Example: Client with 2 facilities Facility 1 = 20m EUR and Facility 2 = 80m EUR plus realised LGD1=20% and realised LGD2=25%. The client’s actual realised loss is 20%*20/100 + 25%*80/100 =24%.

Average weighted averaging of the realised LGDs results in an LGD for the client of

\[
\text{Average} = \frac{(20\% \times 20) + (25\% \times 80)}{100} = 24\%.
\]

This approach is based on geographical regions would be feasible and expedient in the case of globally active borrowers, is also crucial for estimating default rates. The level at which the model is not optimised, calibrated or validated based on this data pool.

### Credit Risk 5.3 Risk quantification

#### Paragraphs 13(a) to 13(d)

Example: Client with 2 facilities: Facility 1 = 20m EUR and Facility 2 = 80m EUR plus realised LGD1=20% and realised LGD2=25%. The client’s actual realised loss is

\[
20\% \times 20 + 25\% \times 80 = 24\%.
\]

The (a) to (e) list in this paragraph represents alternative approaches for identifying the maximum “time-to-workout.”

#### Paragraphs 13(b) to 13(e)

In our view, the volume-weighted aggregation of the facilities at client level is the more appropriate approach, since it is not clear what the added value is of performing all of these analyses. For example, alternative determination methods can be used to validate the results. However, the choice of the method to be used should be a matter for the institutions in order to ensure methodological freedom.

### Credit Risk 5.1 Realised LGD

#### Paragraphs 91(a) to 92(b)

In addition, it is possible that this approach cannot ensure the availability of a sufficient number of observations.

### Credit Risk 5.1 Realised LGD

#### Paragraph 97(c)

In our view, the volume-weighted aggregation of the facilities at client level is the more appropriate approach, since it is not clear what the added value is of performing all of these analyses. For example, alternative determination methods can be used to validate the results. However, the choice of the method to be used should be a matter for the institutions in order to ensure methodological freedom.

### Credit Risk 5.1 Realised LGD

#### Paragraph 103

In our view, the volume-weighted aggregation of the facilities at client level is the more appropriate approach, since it is not clear what the added value is of performing all of these analyses. For example, alternative determination methods can be used to validate the results. However, the choice of the method to be used should be a matter for the institutions in order to ensure methodological freedom.
Paragraph 130 in conjunction with paragraph 128 and 129 requires a data history of 20 years for downturn analyses. This is mitigated by paragraph 128(a), which permits capping to 2008. However, we still regard a data history of 20 years as very long—similar to our comments on EBA consultations on economic downturn LGD RTS (EBA/CP/2018/01), Guideline (EBA/CP/2018/06). Macro-economically, this would cover 2-3 business cycles (Juglar cycle).

Paragraph 120 in conjunction with paragraphs 124 and 125 requires a data history of 20 years for downturn analyses. This is mitigated by paragraph 124(a), which permits capping to 2008. However, we still regard a data history of 20 years as very long—similar to our comments on EBA consultations on economic downturn LGD RTS (EBA/CP/2018/01), Guideline (EBA/CP/2018/06). Macro-economically, this would cover 2-3 business cycles (Juglar cycle).

Paragraph 115(a) explicitly notes that, in a bottom-up approach, the sub-quotia (e.g., separate recovery rates for the collateralised and unsecured portions) should be independent, or any dependency must be reflected in the modelling. This is not explicitly required if a total LGD is estimated directly, possibly with the same components as explanatory variables. It must therefore be ensured that the bottom-up approach is not biased, at least if the model exhibits an adequate forecasting quality even if there are dependencies.

Paragraph 114(a) requires the cohort approach (analyse risk driver within the previous year). However, the sequence of the analysis is not presented in sufficient detail. It is not clear how exactly the NCA should deal with a finding that the risk driver may be very volatile ("When choosing the appropriate reference date for a risk driver, institutions should take into account its volatility over time."). Should there be something?

Paragraph 112(a) explicitly notes that, in a bottom-up approach, the sub-quotia (e.g., separate recovery rates for the collateralised and unsecured portions) should be independent, or any dependency must be reflected in the modelling. This is not explicitly required if a total LGD is estimated directly, possibly with the same components as explanatory variables. It must therefore be ensured that the bottom-up approach is not biased, at least if the model exhibits an adequate forecasting quality even if there are dependencies.

Paragraph 111(a) explicitly notes that, in a bottom-up approach, the sub-quotia (e.g., separate recovery rates for the collateralised and unsecured portions) should be independent, or any dependency must be reflected in the modelling. This is not explicitly required if a total LGD is estimated directly, possibly with the same components as explanatory variables. It must therefore be ensured that the bottom-up approach is not biased, at least if the model exhibits an adequate forecasting quality even if there are dependencies.

Paragraph 110(a) explicitly notes that, in a bottom-up approach, the sub-quotia (e.g., separate recovery rates for the collateralised and unsecured portions) should be independent, or any dependency must be reflected in the modelling. This is not explicitly required if a total LGD is estimated directly, possibly with the same components as explanatory variables. It must therefore be ensured that the bottom-up approach is not biased, at least if the model exhibits an adequate forecasting quality even if there are dependencies.

Paragraph 109(a) explicitly notes that, in a bottom-up approach, the sub-quotia (e.g., separate recovery rates for the collateralised and unsecured portions) should be independent, or any dependency must be reflected in the modelling. This is not explicitly required if a total LGD is estimated directly, possibly with the same components as explanatory variables. It must therefore be ensured that the bottom-up approach is not biased, at least if the model exhibits an adequate forecasting quality even if there are dependencies.

Paragraph 108(a) explicitly notes that, in a bottom-up approach, the sub-quotia (e.g., separate recovery rates for the collateralised and unsecured portions) should be independent, or any dependency must be reflected in the modelling. This is not explicitly required if a total LGD is estimated directly, possibly with the same components as explanatory variables. It must therefore be ensured that the bottom-up approach is not biased, at least if the model exhibits an adequate forecasting quality even if there are dependencies.

Paragraph 107(a) explicitly notes that, in a bottom-up approach, the sub-quotia (e.g., separate recovery rates for the collateralised and unsecured portions) should be independent, or any dependency must be reflected in the modelling. This is not explicitly required if a total LGD is estimated directly, possibly with the same components as explanatory variables. It must therefore be ensured that the bottom-up approach is not biased, at least if the model exhibits an adequate forecasting quality even if there are dependencies.
We ask for clarification, which market factors are to be included as general risk factors and which are not, for instance are implied volatilities and correlations, dividends, tenor-spreads, collateral spreads, and others are to be included.

We would also like to point out that there should be a clear understanding of what in detail is included as specific risk within the Standardised Approach. If for example all credit spread risks from bonds and credit derivatives are included, banks with partial-use IMA for general interest rate risk, who include general credit spread risk within general interest rate risk, would be double counting those risks. However, if they aren't included within specific risks of the SA, paragraph 21 will lead to a non-capitalisation of credit spread risks.

Andrea, Silvio
German Banking Industry Committee
Prahlath

In the paragraph it is stipulated that a given day should be considered as a business day for VaR and backtesting, even if it is a holiday for the major part of the institution and only a "reduced number of staff" is in operation.

Please note that usually these staffs are just for "firefighting", no regular trading or similar operation is taking place. Hence the first two sentences of this paragraph should be deleted, the decision whether a (local) holiday is a "business day" for VaR and backtesting should be to the institution's discretion and justified to the satisfaction of the regulator.

Andrea, Silvio
German Banking Industry Committee
Prahlath

In footnote 88, priority is given when calculating the hypothetical P&L to the requirement to use market quotes or pricing methods and model parameterisations used for the economic P&L, over the requirement to change only the risk factors within the risk categories of the IMA. To ensure the integrity and adequate labelling of partial use P&L measures mentioned at the beginning of paragraph 75, there should also be the possibility to calculate the hypothetical P&L reflecting the partial-use modelling. Footnote 88 should be amended correspondingly.

For example, if partial use consists of the general interest rate risk, only the (risk-free) interest rate and the general credit spread risks are modelled in the VaR relevant for reporting in the case of bonds, while the hypothetical P&L should be determined on the basis of their market prices in accordance with paragraph 75. However, in addition to the (risk-free) interest rates, market prices also reflect bond-specific credit spreads, which in turn consist of general and special credit spreads. The hypothetical P&L thus also reflects in particular special interest rate risks, which in turn are explicitly not part of the partial use VaR measure, with the result that no adequate statement on the integrity of the partial use VaR measure can ultimately be made using correspondingly designed backtesting.

Footnote 88 should be amended as follows:

In this view that an exclusion of the P&L stemming from risk categories not included in the scope of the internal model is appropriate. A backtesting of the economic P&L is always, if a market price that incorporates all risks used in the economic P&L, it should also be used in the hypothetical P&L.

Andrea, Silvio
German Banking Industry Committee
Prahlath

"The G1 should be amended accordingly: "...policy in place that ensures processes for deriving and validating each proxy."

Article 367(2)(c) of the CRD states that "...shall be used only where available data is insufficient or is not indicative of the true volatility of a position or portfolio", while the same line Article 367(2)(c) of the CRR require that "the yield curve shall be shifted into a minimum of six maturity segments". If this reduction of granularity would be seen as proxying by Article 367(2)(c) of the CRR would have to be rephrased since interest curve do have more than six pillars with "sufficient available data" in almost all cases, and would thus be allowed for "proxying".

Andrea, Silvio
German Banking Industry Committee
Prahlath

We would also like to point out that there should be a clear understanding of what in detail is included as specific risk within the Standardised Approach. If for example all credit spread risks from bonds and credit derivatives are included, banks with partial-use IMA for general interest rate risk, who include general credit spread risk within general interest rate risk, would be double counting those risks. However, if they aren't included within specific risks of the SA, paragraph 21 will lead to a non-capitalisation of credit spread risks.

Andrea, Silvio
German Banking Industry Committee
Prahlath
7.1 The framework for risks not in the model

7.2 Pricing functions and methods in the model

7.3 Market risk

7.4 Quantification of RNIME

7.5 Management of RNIME and implementation in an institution's risk engines
7.5 Management of RNME and implementation in an institution’s risk engines

Here it is correctly stipulated that RNME is not part of regulatory backtesting. Consequently, since material RNME effects can lead to backtesting outliers, RNME should not be capitalised under pillar 1. Otherwise, if a backtesting outlier is due to RNME effects, RNME is capitalised twice: Once by the VaR/sVaR multiplication factor and once by separate RNME capital add-ons. See also feedback on paragraph 171.

Contrary to the RNME specification in paragraph 183(a), backtesting adequately models and reflects model risks that both underreport and overreport risks and, in particular, their mutual dependencies, contrary to the RNME specification in paragraph 183(b).

In this respect, the objective of adequate own funds requirements for market risk is already fully met by the IMA in conjunction with the backtesting add-on. By contrast, the RNME framework leads to a high level of own funds requirements, among other things through double-counting of the same RNME via the backtesting add-on and the RNME add-ons.