



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 | Market Risk | 7.5 Management of RNIME and implementation in an institution's risk engines | 183 | 130-131 | Amendment | The proposed threshold of 10% for cumulative impact quantification is very small assuming that it includes both capitalised and non capitalised RNIMEs based on threshold of 5% as stated in paragraph 183a. Just 1 or 2 RNIMEs can lead to breach of the threshold prompting the institution to include the RNIME in the model engines. Especially, given many of RNIMEs cannot be calculated using the ideal preferred Incremental Risk number (otherwise those risks would most likely not be classified as RNIME at the first place itself), the impact quantification is usually a highly conservative figure given the lack of options to calculate the risk figure. It is understood from the public hearing that ECB sees the RNIME only as a transitional item with the aim of having all RNIMEs eventually in the model engines, but there are many risk types that cannot be sufficiently estimated using regular VaR models because of the involved complexities and market data limitations, else the RNIME would not be classified as such in the first place itself. Hence from the practical application point of view, we view that firstly the cumulative threshold of 10% can too easily be reached and then in the process to incorporate those RNIMEs in regular VaR models, the institution may be forced to compromise on the quality of method used to do so and hence not meeting the bigger goal of having fair and adequate risk measurements in place. | The threshold beyond which RNIMEs should be included in model engines is not based on a practical assessment of RNIMEs | Van Dijk, Freddy | Rabobank | Publish |
| 2 | Market Risk | 7 Risks not in the model engines | 183 | 130-131 | Clarification | The RNIME does not talk about the any transition to the NMRF which would be used in FRTB or FRTB in general. From the public hearing, it is understood that ECB mentioned that the proposed RNIME framework is not compatible with NMRF specified in FRTB base text. Given, the institutions need to put in investments and resources to set up the RNIME framework and NMRF framework, we need some clarity on the ECB's plans for future and expectations from the institutions: Is the proposed RNIME only seen as a temporary framework which will go out of practice once NMRF framework is in place from 2022 onwards? Can you please share in detail on how ECB views this transition and any ways it can be more smooth and efficient to implement for banks? | Resources and investment planning for RNIME and NMRF framework | Van Dijk, Freddy | Rabobank | Publish |
| 3 | Counterparty Credit Risk | 2.3 Principles for ECB banking supervision | 18 | 138 | Amendment | For all transactions that are not carved out from IMM, the ECB requires to take price differences into account in the modelling of the exposure profiles. Precisely, this should be done for future grid points, only if the difference increases the netting set exposure. We suggest to adjust the difference also at the current grid point 10 of the valuation. The reason is mainly because if this is not done, we would end up with quite unrealistic exposure profiles (a possible jump from the current grid point and the first future grid point). Furthermore, we also suggest to allow for both upward and downward adjustments, i.e. to adjust in both directions to avoid exposure profiles will be too conservative. | Price differences between the benchmark system and IMM should be adjusted for both current and future grid points, not only for future grid points. | Van Dijk, Freddy | Rabobank | Publish |
| 4 | Counterparty Credit Risk | 8.3 Principles for ECB banking supervision | 62 | 159 | Clarification | Should an institution also demonstrate that the quarterly recalibration is sufficient if a calibration to the stressed period is used for internal risk management? | Demonstration that the quarterly recalibration is sufficient is not required if an institution uses the stressed calibration for internal risk management. | Van Dijk, Freddy | Rabobank | Publish |
| 5 | Counterparty Credit Risk | 8.3 Principles for ECB banking supervision | 62 | 159 | Amendment | The recalibration frequency should depend on whether it is a risk neutral or historical calibration. | Recalibration frequency should be chosen dependently on the calibration type. | Van Dijk, Freddy | Rabobank | Publish |
| 6 | Counterparty Credit Risk | 8.3 Principles for ECB banking supervision | 64 | 159 | Clarification | For parameters other than volatilities and correlations, either a calibration to the data from the 3 years stress period or an alternative stress calibration method are seen as compliant. We ask for clarification on the second possibility. If we for example consider the mean reversion speed for interest rates, this must somehow reflect the actual level of the rates which would not be possible if we only calibrate to a three years horizon of stressed data. | Parameters other than volatilities and correlations (such as mean reversion of interest rates) should be calibrated to longer time series and incorporate recent data so to reflect current levels. | Van Dijk, Freddy | Rabobank | Publish |
| 7 | Counterparty Credit Risk | 9.3 Principles for ECB banking supervision | 68 | 163 | Amendment | In point c) it is stated that the assessment of the outcomes of the model and the judgement regarding possible remedies are the responsibility of the validation function only. We agree with the first and ask to remove the second one. In general, the validation function should tell what to improve, not how to improve. Shaping and improving methodologies should be conducted within model development. | It is true that the validation function should assess the model outcomes via backtesting, but how to improve the outcomes should be up to the model development team. | Van Dijk, Freddy | Rabobank | Publish |

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|---|-----------------------------|--|---------|-----------|---------------|---|--|------------------|----------|---------|
| 8 | Counterparty Credit Risk | 9.3 Principles for ECB banking supervision | 72 - 77 | 162 - 165 | Amendment | <p>The ECB sees benefit in back-testing different risk measures, including MMM at transaction level, MM of netting sets as well as the exposure of netting sets. In general, backtest on transaction level can turn out to be very computationally intensive or even prohibitive as it means running computationally expensive Monte Carlo for each transaction (on a daily basis) and this might be hundreds of thousand trades in the case of large banks. Larger banks, on the other hand, have numerous netting sets, some of them single transaction netting sets only, thus a very big sample for which the backtest can be run. Should backtesting on the single transaction level fail, significant amount of netting set-level backtests would fail too. We thus believe the transaction level backtest is mainly beneficial for smaller banks which have smaller amount of netting sets. In such cases backtesting might not give a clear picture about the model ability to capture the pricing accuracy. Can ECB provide a finer statement about what backtest is recommended for which bank? For example, banks with smaller sample of netting set would benefit the most from the transaction level backtest.</p> | <p>Backtesting on a transaction level is too time consuming and not even necessary, when the institution deals with large samples of netting sets.</p> | Van Dijk, Freddy | Rabobank | Publish |
| 9 | Counterparty Credit Risk | 9.3 Principles for ECB banking supervision | 76 | 165 | Clarification | <p>Changes of the portfolio composition (due to new or maturing transactions) during the observation period should be "handled accordingly" when performing portfolio back-testing. The maturing transactions are not difficult to handle because under the full valuation, the expiring transactions are no longer in the exposure profile after they have expired. On the other hand, new transactions started during the backtesting window (t, t+h) might impair the backtest as those were not known when the exposure profiles were generated. We reckon that a proper handling of these new transactions could be done by exclusion of these new trades. Is this what ECB means by "handling"? This exclusion could be reflected by calculation of netting set MMM at time t+h only from transactions that were known at time t (i.e. to exclude transactions that originated between t and t+h). However, as banks have to backtest exposures (not MMM), collateral must be reflected. Yes, collateral observed at t+h is based on all transactions seen at t+h in the netting set. If banks want to perform a credible backtest, can the collateral at t+h be adjusted (allocated) for transactions that originated between t and t+h? For the backtesting purposes, is there an ECB recommended/approved approach to the exclusion of the new transactions and adjustment/allocation of the collateral?</p> | <p>We propose that a possible handling of the portfolio composition over time could be performed via excluding new transaction arising during the backtesting time window. Problems though would arise when dealing with the collateral.</p> | Van Dijk, Freddy | Rabobank | Publish |