Template for comments

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

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<td>Contact person</td>
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General comments
UniCredit welcomes the opportunity to comment on the ECB TRIM Guide – specific risk chapters.

Besides more detailed remarks and proposals in the ‘Comment spreadsheet’, below the following general comments:

Regarding the Credit Risk Chapter, the main areas of attention are the following:
• external data/bureau for which it is suggested to have specific guidelines addressed to both financial institutions and external data providers;
• pool model concerning the adoption of data from different institutions of the same banking group;
• critical points from EBA guidelines confirmed such as independence period, discount of the artificial cashflow and downturn (on which EBA guidelines are still in consultation and whose principles have been extended to CCF.

Furthermore several clarifications have been requested in order to avoid possible future misinterpretation. Therefore on these points it was difficult to provide a punctual feedback. In particular the most relevant topics are the estimation of MoC category C, the treatment of repossessed asset, full review of estimates and the requirements on grade assignment dynamics.

For what concerns the Market Risk chapter, the main point of attention is the un-anticipated introduction on a new IMA component: the Risk Not in Model Engine.

While the monitoring of RNIM and the introduction of capital add-on in the presence of material price risk not captured by the Market Risk Models appears as a sound practice, the introduction of Risk Not in Model Engines under the IMA seems to go beyond CRR prescriptions and poses serious concerns when it comes to model approval and model change procedures.

Additionally the scope of RNIME - in its current definition - appears much broader than the “material price risks” CRR refers to, effectively overlapping with model risk framework, Risk Appetite Framework and New Product Processes.

Finally, CRR foresees capital add-ons in terms of increase to the regulatory multiplier which could already cover for some of the newly prescribed RNIME add-ons, effectively leading to a double-counting on the same risks.

Regarding the CCR sections, the carve out requirement for trades that show pricing discrepancies over defined thresholds with respect to benchmark seems to be over-reaching. This is particularly true for Banks that share the same pricing framework in FO and Risk for which a quarterly monitoring should be sufficient to detect the “unacceptable performance” the CRR refers to. Additionally the proposal for margined trades does not seem to properly account for the benefits of collateralization rather addressing diversification effects.

Finally, the prescription of including cash-flows in the margin period of risk, requires the inclusion of detailed contractual settlement information into the CCR Engine (which accounts only for pre-settlement exposure), a requirement that is not clearly spelled in CRR which rather deals with Settlement and Pre-Settlement risks as distinct risk types.
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<th>Chapter</th>
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<th>Detailed comment</th>
<th>Concise statement as to why your comment should be incorporated</th>
<th>Name of commenter</th>
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<tr>
<td>1</td>
<td>Credit Risk</td>
<td>2.4 Data quality management framework</td>
<td>30</td>
<td>11</td>
<td>Clarification</td>
<td>It is not clear how banks are supposed to comply with this requirement, given that they have limited leverage on data providers, to require disclosure of their data quality treatment. Therefore we suggest to better clarify and describe in detail a more explicit set of information that are necessary to be disclosed, eventuating foreseen on this a dedicated guidelines subject to a consultation process target to both banking system and most common external data providers.</td>
<td>Clarification required due to the difficulty of gathering information on external data providers data quality treatment.</td>
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<td>2</td>
<td>Credit Risk</td>
<td>3.2 Use of external data</td>
<td>34, 35</td>
<td>15</td>
<td>Clarification</td>
<td>Generally speaking, we deem that the analyses reported in section 3.2 for the use of external data might be likely not sustainable, since they entail a level of disclosure closed to the one available for internal data (for example: representation/non analysis of par. 35). This disclosure level is usually not possible for data providers. In practice, these requirements, if met as for the current formulation reported in the draft Guide, might lead to the possibility of adopting external data policies with the systems, introduction of a material Margin of Conservatism not linked to a specific rank ordering and predictive power, which is expected to be significantly lower. However inconsistency arises with the top down approach foreseen in EBA/CP/2018/10 (in the conditions to allow institutions to calculate KIRB in accordance with the purchased receivables approach under Article 255 of CRD), in which the methodological approach will rely primarily on external data, given the impossibility to leverage on internal data being not representative of the scope of this model. Therefore the analysis required by ECB guidelines ought clear into the variability of the new securitization framework aiming at meaningful, as far-based creditworthiness frameworks, the securitization business.</td>
<td>Requirements on external data might compromise their adoption in the future and they might likely limit the new securitization framework.</td>
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<td>3</td>
<td>Credit Risk</td>
<td>3.3 Use of external bureau scores or models in credit assessment procedures</td>
<td>27</td>
<td>16</td>
<td>Clarification</td>
<td>The previous comments regarding the level of disclosure required for external data apply in particular in the case of external credit bureau scores. In addition information on the structure and nature of external scores and their key drivers are required (par. 37(b) et seq) but are usually not reported by credit bureau. For example, shadow rating models, or single legal entity level would provide a partial (and potentially biased) view. We propose the following amendment of requirements on external scores might compromise their adoption in the future.</td>
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<td>4</td>
<td>Credit Risk</td>
<td>3.5 Use of purchased rating systems or models (pool models)</td>
<td>43(1)</td>
<td>19</td>
<td>Amendment</td>
<td>In our opinion the current para. 5(1) of the pool model (including testing of discriminatory power and predictive power) should be applied to each institution on its own portfolio. &quot;Model in connection with footnote 21&quot; should be removed. Instead in the case of pooled model scores legal entities of the same banking group (i.e. group-wide models) the performance of application is related to the entire group of entities. As such it should be extralateral (at least) and consistent with those required in a group-wide framework. This could hinder the usefulness of pooled data sources for risk differentiation purposes, limiting, in violation of regulatory requirements, the ability of the estimates and the information completeness of the rating system (the Credit Bureau are usually relevant information for rating assignment especially in the &quot;through-the-door&quot; initiative for new clients or applications on Retail segment). We therefore suggest to better clarify and describe in detail a minimum set of information that are necessary to be disclosed, eventually foreseen on this a dedicated Guidelines subject to a consultation process target to both banking system and Credit Bureaus itself.</td>
<td>Regulatory requirement on group-wide models not consistent with group-wide nature of the models themselves. Requirements on external data might compromise their adoption in the future and they might likely limit the new securitization framework.</td>
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<td>5</td>
<td>Credit Risk</td>
<td>4.1 Structure of PD models</td>
<td>32</td>
<td>21</td>
<td>Amendment</td>
<td>It should be specified that in case of analysis applied at sub-range level, a lower performance with respect to the overall model is expected.</td>
<td>Lower performance structurally expected in case of sub-ranges of application</td>
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<tr>
<td>6</td>
<td>Credit Risk</td>
<td>4.1 Structure of PD models</td>
<td>32, footnote 24</td>
<td>21</td>
<td>Deletion</td>
<td>In our opinion it is useful to perform a differentiation of a maximum/minimum differentiation for subranges in which one of the main drivers of the internal rating as being. In our opinion, being the most informative risk indicators, the model performance is expected to be significantly lower. However in the specific case of credit bureaus, the lack of availability of the information is itself a driver considered by the model. This is particularly true in the application scope of retail models.</td>
<td>Significantly lower performance structurally expected in case of not availability of credit bureaus, when this information is one of the main risk drivers.</td>
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Not clear requirements on grade assignment dynamics

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Better specification on the cases where a facilities aggregation is needed.

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Analysis of curing process already required for probation period with consequent double operational effort

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Alignement with EBA/GL/2017/16 requirement in case of adoption of direct PD estimates

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In order to calculate LRA LGD, "in the event of definition of default applied at obligor level, where two facilities of the same obligor are assigned to the same facility grade or pool, two options are seen as compliant for calculating the average", institutions should "compute the average weighted by the total number of facilities within that facility grade. This first option among the two proposed should be adopted as a general option comparing with the EBA requirement of the facility level estimation. The other option could be considered in the exceptional cases wherein the client level LGD estimation is applied as defined in the Article 96. In this case, the client level weight LGD should be applied. Institutions should demonstrate that the approach they use does not distort the observed loss." What analysis is deemed sufficient to analyze distortion of the observed loss, given that is an average value of all the losses?

In the Article 96, in this case the client level weight LGD should be applied. The other option could be considered in the exception cases where the client level LGD estimation is applied as defined in the Article 96. In this case, the client level weight LGD should be applied. Institutions should demonstrate that the approach they use does not distort the observed loss. Amended text:

113 Under paragraph 151 of the EBA GL on PD and LGD, institutions should calculate the LRA LGD as an arithmetic average of historical LGDs over a historical observation period weighted by a number of defaults. When performing this calculation, institutions should observe the following points.

(a) in the event of definition of default applied at obligor level, where two facilities of the same obligor are assigned to the same facility grade or pool, two options are seen as compliant for calculating the average, institutions should "compute the average weighted by the total number of facilities within that facility grade. This first option among the two proposed should be adopted as a general option comparing with the EBA requirement of the facility level estimation. The other option could be considered in the exceptional cases wherein the client level LGD estimation is applied as defined in the Article 96. In this case, the client level weight LGD should be applied. Institutions should demonstrate that the approach they use does not distort the observed loss." What analysis is deemed sufficient to analyze distortion of the observed loss, given that is an average value of all the losses? [removed the remaining part requiring the adoption of risk drivers as sub-ranges drivers].

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We agree that if high LGD realizations are due to economic and structural reasons on cap should be applied but rather the logic should be driven more by potential interconnections among elementary facilities affecting each other the behavior of the drawing of the unused credit line. As a consequence of this, the phenomenon reported within this paragraph should not be an area of investigation anymore.

Delete the article as it is redundant and not fully consistent with the article 182 (1) (b) of CRR De Palma, Valeria UniCredit Publish

According to paragraph 162 of the EBA GL on PD and LGD, institutions should apply an appropriate treatment to outlier values that can introduce a potential bias in the estimates. We agree that if high LGD realizations are due to economic and structural reasons no cap should be applied but rather the logic should be driven more by potential interconnections among elementary facilities affecting each other the behavior of the drawing of the unused credit line. As a consequence of this, the phenomenon reported within this paragraph should not be an area of investigation anymore.

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We agree with the wording making reference to possible aggregation according to the characteristics of the facilities rather than adopting aggregations valid on UCD size.

Amend the wording making reference to possible aggregation according to the characteristics of the facilities rather than adopting aggregations valid on UCD size.

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To be clarified that the MoC should not be independent from the yearly default risk volatility and should depend on number of observations.

Paragraph 15 suggests that any adjustment to the scope of the FRTB should be based on the number of observations available rather than the volatility of the risk factors. This is difficult to see since all default risk variances are calculated on a daily basis, taking into account the historical volatility of the underlying risk factors. Therefore, it is not clear how the MoC should be calculated.

The paragraph expects to harmonize the standards of the internal policies describing the FX Position consolidation process, in the absence of a sufficiently detailed regulation on how the consolidation be carried out. Harmonization should start from the consolidation principles in the first place.

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The paragraph requires that the institution uses any further assumptions on non-price parameters that it deems necessary to demonstrate that the chosen assumptions appropriately capture the risk of its portfolio. "Instead", institutions choosing the unsupervised approach should be required to prove adequacy of such choice to reflect the risk of their portfolio. Such assumptions "indeed can be considered as conservative, assigning to all positions in the portfolio the pass-through liquidity and removing the diversification effects generally arising from replacement of defaulted issuers within the capital horizon. This also means to be reflected in the formulation of CRR Article 374(4), where see- the comment: position is presented as a fall-back case, alternative to the liquidity horizon assessment required for the constant level of risk assumption. We suggest to amend the paragraph to clarify that one-year constant position assumption does not imply, in itself, to be a position in terms of adequacy.

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The paragraph requires that the framework should not follow under the same standards of the IMA component, while the risk unit certainly has the duty of monitoring the framework. Even according to prescriptions detailed in paragraph 172, the handling of the framework should not be subject to the same standards of the IMA component,

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The paragraph requires that the framework is static by definition, so that the portfolio is static by definition. The paragraph requires that the framework is static by definition, so that the portfolio is static by definition. The quantification of the adequacy of a risk model should be based on objective measures like BackTesting.

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Markit Risk 7.4 Quantification of RNIM 177 127 Amendment The paragraph prescribes the same level of conservatism in the quantification of the RNIM of the metric they refer to in the light of the fact that no diversification is allowed between them and that the only practical assessment could be due to pricing misalignment, this should be supply driven and unlikely to be too conservative. The quantification is not conservative and too conservative standards in the quantification of the RNIM. De Palma, Valeria UniCredit Publish

Markit Risk 7.4 Quantification of RNIM 170 126 Amendment (i) Incremental measurement can only be obtained by including the RMIME in the total. The requirement appears hence imposed since the standalone assessment will be conducted on an standalone basis, which is bound to be too conservative. Additionally any capital add-ons that might be quantified for a RMIME should not be computed with any aggregation of the regulatory multiplier caused by back-testing exceptions shown by the RNIM. The paragraph is too conservative and no conservative standards in the quantification of the RNIM. CRIS clearly prescribes a simple increase mechanism to compensate for model inaccuracies and this should not be compounded with adverse. De Palma, Valeria UniCredit Publish

Markit Risk 7.3 Management of RMIME and implementation in an institution’s risk engines 192 129 Amendment Use of diversification benefits and standalone calculation of RNIM impacts will lead to over-extractions of the relevance of both risks which, once embedded in the model, might as well prove irrelevant on the risk metrics. The quantification approach appears over-conservative and bound to generate capital add-ons in excess of what the actual impact on the risk measures will be upon model inaccuracies. The 5% and 10% thresholds mimic those of the EBA RTS on model change invariability however refer to a quantity that does not share the same characteristics as on RNIM. De Palma, Valeria UniCredit Publish

Markit Risk 7.3 Management of RMIME and implementation in an institution’s risk engines 186 132 Deletion Considering RMIME as part of RMIM seems out reflecting the CRIS prescriptions around the completeness of the price capture. Additionally, having it subject to the EBA RTS on model change will trigger even further a model change mechanism that is already providing a solution to normal model maintenance operations. It is also unclear how this part of the model will be dealt with in the context of ITCoR coming into force, i.e. if it will be impacted by the same supervisory rules or a model change mechanism for the RNIM set up that might not even reach the approval phase if ITCoR before 01/01/2022 is confirmed. The inclusion of RMIME in RMIM framework appears unnecessary. Interaction mechanism with ITCoR coming into force is also unclear and exposes to the risks of a wave of model approvals that will be short lived as encoded at all. De Palma, Valeria UniCredit Publish

Counterparty Credit Risk 2 Trade coverage 15-19 137-138 Amendment Provided that CRR introduces "unsustainable performance", a carve out can be described in par 14 to 18 to be consistent with par 15 demands for a detailed assessment. It is also the case that impacts on the Regulatory requirement of models could not be material at all. We deem that a fair approach would be the following:

1) estimate the material differences (2) estimate impacts on EPE (3) proceed to carve out if and only if material overdemand over base line.

An automatic carve out would prohibit banks that have aligned pricing infrastructure with the 10 with nominal cases of differences. In addition, for marginal exposure, in case new collateral at all is used, we deem that the request is not dual conflicting/pricing inadmissible. The CRR only mentions "unsustainable performance". A fair trade exceeding the thresholds could not affect RWA computation in an appreciable way. An overrelying should be sufficient. De Palma, Valeria UniCredit Publish

Counterparty Credit Risk 2 Trade coverage 15 127 Amendment Although we acknowledge that "observed differences occur for losses from [net business day] during the relevant quarter" is an implementation to previous guidelines, daily process is demanding (will be) for operational point of view, and at least for banks that share the same pricing models between Front Office and Risk this request should not be mandatory, otherwise we frame the request of monitoring, but we deem that banks should be allowed to set-up their internal processes provided that no collateral deterioration is guaranteed. Monitoring Request on a quarterly basis, followed by drift down analysis for trades exceeding the thresholds and impact at overall level should be deemed sufficient at least for the Banks that share the same pricing models in Front and Risk environment. De Palma, Valeria UniCredit Publish

Counterparty Credit Risk 2 Trade coverage 16 138 Amendment CRR only monitors "unsustainable performances" and paragraph 16 seems to associate par 15 thresholds to "unsustainable performance". A further attention to carve out in inadmissible would be to perform impacts an EPE due by pricing inadmissibility, and only in case impacts are material perform the carve out. Monitoring Request on a quarterly basis, followed by drift down analysis for trades exceeding the thresholds and impact at overall level should be deemed sufficient. De Palma, Valeria UniCredit Publish

Counterparty Credit Risk 2 Trade coverage 19 138 Amendment Option (2) should be allowed, since it provides more flexibility. Option (2) should be allowed, since it provides more flexibility. De Palma, Valeria UniCredit Publish

Counterparty Credit Risk 2 Trade coverage 21 c) 143 Amendment Counterparty Credit Risk Models, aiming at computing RWA for PRS settlement risk, usually do not embed all the settlement factors that are needed for a proper modeling of Settlement Risk. As a consequence, we see that 21 c) is over-conservative with respect to CRR requirements. As such, we propose to remove 21 c) showing this aspect does overall nothing setting at least between different leg of the same trade, removing the reference to settlement risk at all. Option (2) should be revised by removing the reference to settlement risk at all. De Palma, Valeria UniCredit Publish

Counterparty Credit Risk 2 Trade coverage 26 149 Clarification Clarification could be useful on the fact that the yearly verification is due only in case Real Collateral is not used at all. Clarification could be useful on the fact that the yearly verification is due only in case Real Collateral is not used at all. De Palma, Valeria UniCredit Publish

Counterparty Credit Risk 3 Modelling of initial margin 41 102 Clarification Formula (13) should be clarified "all contractual elements". COP Models are not available to Banks for a fully fledged simulation. Formula (13) should be clarified "all contractual elements". COP Models are not available to Banks for a fully fledged simulation. De Palma, Valeria UniCredit Publish
Provided that the possibility to unilaterally unwind the transaction is a risk mitigation, we deem that it should be properly embedded in the TRIM guidelines, replacing the average lifetime of transactions, that correspond to a "business as usual case". We would suggest replacing "the average lifetime of the transaction type under consideration in the last two years with the same or comparable counterparties, subject to a cap of any year", replacing it with "notice period".

We deem more appropriate to set the threshold at 10%, as it was in previous TRIM version.

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We deem that a 5% impact is too close to a typical error, and considering that regulatory alpha does already include a conservative buffer, we deem that it is more appropriate to rely on 10% threshold.

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In case of drift, a calibration out of stress period is not always feasible or meaningful. Furthermore, the request of "showing that does not underestimate exposure" is prone to interpretation.

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The sentence "for the respective validation task is conducted on behalf of the validation function" should be removed.

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A 50% ratio would not fit to all methodologies. Banks should be asked to develop their own methodologies and set the thresholds accordingly. The usage of "simple number bases" could be misleading. As such, we would suggest a wording "removing "next to simple number basis" and replacing (50%) with "an internal threshold, agreed with the validation function, deemed adequate for banks portfolio"

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