



EUROPEAN CENTRAL BANK
BANKING SUPERVISION

Feedback statement

Responses to the public consultation
on the draft ECB guide to banks on
materiality assessment for IMM and A-
CVA model extensions and changes
(EGMA)

BANKENTOEZICHT

September 2017

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1 Overview and analysis of responses

On 16 December 2016 the European Central Bank (ECB) launched a public consultation on the draft ECB guide on the materiality assessment (EGMA) for extensions and changes to the internal models used by banks to determine counterparty credit risk (CCR) and credit valuation adjustment (CVA) risk. This public consultation, which was conducted in accordance with Article 4(3) of the Single Supervisory Mechanism (SSM) Regulation¹, ended on 13 February 2017. Besides inviting written comments, the ECB also gave industry participants and interested parties the opportunity to provide additional input at a public hearing with senior representatives of the ECB. This event was conducted through a conference call on 13 January 2017. While the comments provided during the public hearing are not reflected explicitly in this feedback statement, they have nonetheless been taken into account. Moreover, most (if not all) of the comments submitted at the public hearing have also been reiterated in written submissions. Thus, the ECB has given due consideration to all of the comments received during the consultation period.

In total, ECB Banking Supervision received two responses. One contribution was submitted by a credit institution and the other by a banking association.

The feedback statement presents an overall assessment of the comments received in the public consultation and aims to address the most relevant issues raised in them. Amendments to the ECB guide have been made as a result of the comments received.

A complete draft proposal for the adoption of the Guide was transmitted by the Supervisory Board to the Governing Council of the ECB on 11 September 2017. The Guide, as adopted by the Governing Council of the ECB on 18 September 2017, was published on the ECB website together with this feedback statement on 25 September 2017.

¹ Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63)

2 Explanation of the proposal and policy rationale

The Capital Requirements Regulation (CRR)² requires model approval by the competent authority for material model extensions and changes to credit, operational and market risk internal models. Regulatory technical standards (RTS) have been adopted by the European Commission for the materiality assessment of model extensions and changes to the internal ratings-based approach (IRB approach) for credit risk; the advanced measurement approach (AMA) for operational risk and the internal models approach (IMA) for market risk. Based on these RTS, model extensions and changes to internal models are categorised as material extensions and changes that require prior approval from the competent authority or as extensions and changes that are not material and require either ex ante notification or ex post notification.

For counterparty credit risk (CCR) for both the internal model method (IMM) and the advanced method for credit valuation adjustment risk (A-CVA), the adoption of similar RTS is not mandated by the current text of the CRR. However, it should be borne in mind that the European Banking Authority (EBA) may regulate this field by adopting guidelines on the basis of Article 16 of the EBA Regulation³ or RTS based on any future EU legislation.

This ECB Guide on materiality assessment (EGMA) for IMM and A-CVA model extensions and changes is adopted in the context of the ongoing review of the permissions to use internal approaches and indicates how the ECB intends to interpret the existing legal framework. The EGMA provides assistance to significant institutions in their self-assessment of the materiality of changes and extensions to IMM and A-CVA models under the applicable legal framework. The Guide is an integrated document intended to be applied in its entirety. Applying only individual elements is likely to distort the coherence of the assessment process and should be avoided insofar as possible.

The EGMA is not intended by the ECB to have legal effect and nothing within its wording and context or its substance should be construed otherwise. The EGMA merely proposes a course of action to be followed by the institutions concerned within the applicable legal framework. The EGMA is not intended to replace, overrule or affect in any other way applicable EU and national law.

² Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

³ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

3 Comments

Respondents commented that the materiality assessment process triggered by the Guide might delay some IT implementations. The ECB considers that the proposed Guide is already more flexible than the corresponding RTS on market risk⁴.

Therefore, delays in IT implementations are less likely for counterparty credit risk than for market risk. The ECB points out that institutions should generally adapt their IT processes and IT implementations so as to accommodate the possible need for approval for model changes.

Respondents sought clarity on model maintenance being out of scope of the Guide. The EGMA was accordingly amended to define model maintenance and to clarify that it is not covered by this Guide.

One respondent was concerned that the necessity to request approval for (partial) reversion to a standardised method is too burdensome where the absence of market data no longer allows processing of trades within the IMM. The ECB would like to mention that such cases may, on a case-by-case basis, be considered model maintenance.

Respondents were concerned that the impact calculation requested in the Guide will be too complicated due to the necessity to run an impact calculation on IMM and CVA. Similarly, respondents were concerned that adjustments of LGD, PD or M parameters could trigger the quantitative threshold of the EGMA. The ECB explains that first – as displayed in the flowchart in Section 4 of the Guide - for model changes to the IMM, only the impact calculation for IMM is relevant. Second, the ECB would like to clarify that IRB parameter changes do not trigger material model changes in the CCR context. Third, IMM and IMA model changes do not trigger A-CVA model changes. For extensions and changes to the IMM approach that need to be investigated, however, the quantitative impact on the minimum capital requirement for CVA risk has to be provided to the supervisor.

Respondents sought clarity on the scope of the quantitative impact regarding merging or splitting model changes. As mentioned in Section 3 of the Guide, a) one extension or change may not be split into several changes or extensions of potentially lower materiality and b) several different extensions or changes may not be merged into one change or extension of a potentially lower materiality. For instance, a change in the interest model should not be split by currency. Moreover, a model change with regard to equity should not be merged with a change with regard to interest rates.

⁴ Commission Delegated Regulation (EU) 2015/942 of 4 March 2015 amending Delegated Regulation (EU) No 529/2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council as regards regulatory technical standards for assessing the materiality of extensions and changes of internal approaches when calculating own funds requirements for market risk.

Respondents sought clarification on the inclusion of securities financing transactions (SFTs) for which the capital charge is computed using the standardised approach. The ECB amended the EGMA to clarify that SFTs, in accordance with Part Three, Title II, Chapter 4 (limited to SFTs) of the CRR, are included in the institution's overall risk-weighted exposure amounts for the CCR.

One respondent sought clarification on the determination of the stressed period calibration. The ECB took the comment into account and amended the Guide, such that the recalibration of the stressed period is not a model change to be investigated. However, any change in the methodology to determine the stressed period is considered a model change that needs to be investigated.

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