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Sent by email to: EBA-CP-2013-02@eba.europa.eu
Subject: BBVA Position paper on EBA draft Regulatory Technical Standards
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BBVA Group welcomes the opportunity to comment on the consultation paper *Draft Regulatory Technical Standards on the conditions for assessing the materiality of extensions and changes of internal approaches when calculating own funds requirements for credit, operational and market risk,* issued in March 2013

We congratulate the EBA for its continuous work towards better regulation and supervision of the financial markets and appreciate the EBA attempts to improve consistency through the discussion paper.

We broadly support the main comments given by the European Banking Federation (EBF). Additionally, BBVA Group would like to point out several concerns and observations about the RTS draft, which are described in the attached document *BBVA Position Paper on EBA/CP/2013/02*. We hope it is useful as input for the finalization of the draft implementing technical standard and are happy to discuss our comments if deemed useful.

Please treat this feedback as confidential.

Yours sincerely,

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Global Supervision Relations – Capital Measurement
Director

Position Paper on EBA/CP/2013/02

General Overview

BBVA Group welcomes the opportunity to comment on the EBA draft consultation paper Regulatory Technical Standards EBA/CP/2013/02. It provides a useful guidance that will contribute to a better understanding of the governance to be followed for regulatory internal models extensions and modifications.

Please find below our overarching remarks:

- There is a growing need to improve the governance framework and clarify the procedure to be followed in modifications and extensions of internal models used for regulatory capital calculations. We nevertheless regret that, overall the document is too prescriptive and, in some cases, does not highlight clearly enough the requirements. This framework should grant institutions sufficient flexibility in order to adapt models to the rapid changes in market conditions to manage their portfolios (for example, changes in pricing and revaluation models for new products, new payoffs or underlying assets, volatilities changes or newly estimated credit risk parameters). If the validation process requires too much time, the institution's capacity to calculate capital requirements accurately will be limited.
- The consultation paper is focused on regulatory internal models modifications and extensions, but also encompasses other related aspects such as organisational changes or the stress testing process, that we consider should be treated separately. We acknowledge the importance to regulate these items but we understand it would be more effective to do so in an independent and more specific document. Modifications to the organisational and operational structure of risk management, internal governance process and control environment are classified as changes requiring ex ante notification to competent authorities. However, due the nature of these changes, we believe they cannot always be anticipated.
- Further clarification is required to calculate quantitative thresholds. In some cases, calculating them might be very demanding from a technological point of view, and impossible to meet due to data availability and timing restrictions. Also, we would like to receive further clarification regarding the criteria to be followed when assessing the aggregate impact of a particular extension or change together with

the impact of all other extensions or changes which are triggered by the same underlying reasons as indicated in *Title I. Article 2.3 Page 12.*

- Further clarification is required regarding documentation, communication process and deadlines.
    - When changes are classified as material, it is not clearly specified how many months in advance must be informed to the competent authorities.
    - In case of extensions and changes which shall be notified to competent authorities (at least three months before their implementation); if the supervisor does not respond before implementation, should the institution take the approval for granted and implement the changes?
    - We consider quite difficult to meet model changes or estimated parameters documentation deadlines, which are established in three months for modifications requiring ex ante notification. It is important to bear in mind that methodological improvements to models are very often performed and notifying them three months before implementation will reduce the flexibility needed to adapt to the new environment. It must be taken into account that Validation Unit would require also a period (at least three months) in order to elaborate their report and give an opinion. This implies that documentation must be available for their revision even before.
    - We would like the paper to be more specific in terms of documentation requirements. For instance, clarify what is exactly requested in *Title V. Article 9 (h, i) Page 19* Required documentation for validation approval: 'Record of the institution's current and past version of internal models' and 'details of all extensions and changes planned for the internal approaches over the next 12 months, where the risk weighted exposure amounts or, where applicable, the own funds requirements are expected to decrease in the case of the IRB approach or the AMA, or expected to change in the case of the IMA'.
- Changes in the criteria for the selection, update or review of used distributions and methods for the estimation of their parameters should not require ex ante notification to competent authorities, providing that the current methodology and detailed procedure to perform these changes have been already approved by the competent authorities.

Comments by Risk Type

Please find below other concerns classified by risk type, with reference to each specific section of the document.

Credit Risk

1. Further clarification is needed to understand what is required to prove the 'representativeness' of the data used to build the model and the 'comparability' of the population of exposures represented in the data used for estimation stated in *Annex 1, Part I Title I 1 (c) Page.20* in order to provide for a complete description of the criteria and measures for classifying the materiality of changes into this category.
2. In *Annex 1 Part II Title II 6 (d) Page.23* changes in the length and composition of time series used for parameter estimation that go beyond the annual inclusion of the latest observations would require ex ante notification to competent authorities. However, we consider that anticipating these modifications three months beforehand is too prescriptive and reduces flexibility.
3. According to *Annex 1 Part II Title I 1 Page.21* changes in the methodology of assigning exposures to exposure classes and rating systems is ranked as material. We would like to clarify that only changes in methodology might be material, but not data modifications as a consequence of portfolio profile migrations or segments redefinition (providing that the segmentation methodology remains the same).
4. When several changes are performed to IRB models at the same time, it seems very complicated to isolate the quantitative impact in order to assess each of them. Also, in order to properly rank changes, we consider that quantitative impact must be evaluated at portfolio level, and not at model level.

Operational Risk

1. Guidelines are required to establish relevant indicator mentioned in *Annex 2.Extensions and changes to the AMA Part I. Title I (5) & Title II Page.24*
2. Clarify the method for setting the level of losses threshold above which the model is fitted to the data described in *Annex 2.Extensions and changes to the AMA Part II. Title II (4a) Page.25* and its relation to the loss events gathering and body-tail modelling thresholds.
3. Explain which is the relevant indicator assigned to the areas to be used when determining that an area account more than 5% of the institution or group as measured at the end of the last financial year, described in *Annex 2, Part I, Title I (5) y Title 2 Page.24,* in order to evaluate the introduction of the AMA within parts of the institution or group of institutions not yet covered by the approval or the approved roll out plan.
4. We consider that changes in the organisational and operational structure of the independent risk management function for operational risk that lead to a reduction

of the available resources in terms of budget and headcount of more than 10 % since the last approval was granted as defined in *Annex 2. Part II. Title II (2) (b) Page.25,* should depend on the context of the institution at the moment of the comparison. For example, if the operational risk budget and structure is falling in an equivalent reduction as the institution overall budget, it should not be considered outstanding.

5. *Annex 2. Part II. Title I (5) Page.25* and *Title II (8) Page.26* describe that reducing the part of the operational risk captured by the AMA within the institution or group of institutions using the AMA if those areas account for more than 1 % of the institution's or group's overall own funds requirements for operational risk would be material (more than 5%) or require ex ante notification to competent authorities (more than 1% but less than 5%). It would very helpful to clarify whether the mentioned percentages apply to institution's or group's overall own funds requirements for operational risk.

Market Risk

1. When calculating the different thresholds stated in *Title IV Article 7. 1.(c) Page 17* in order to determine IMA material extensions and changes, two different configurations (batch processes) must be set, which would became impractical from a technical standpoint as the increase shall be calculated by dividing 60 observations before and after methodological modifications have been implemented.
2. According to *Title IV Article 8 (a) Page 17,* changes to the IMA model falling under *Annex 3 Part II Title II* shall be notified to competent authorities one month before their planned implementation. However, it will be not always possible to anticipate modifications one month in advance when modifications to the model must be implemented immediately. For instance, a change to the stressed period required when Normal VaR is higher than Stress VaR cannot be predicted beforehand. It depends on the behaviour of the stressed period during 30 days and the result of the quantitative impact that requires analysing 60 observations before and after model changes, what is quite demanding from a computational point of view as it requires maintaining a parallel run environment. Also, it will take at least a month to reflect the change in the capital reporting. As supervisory approval is not required, we propose notifying these changes after implementation.
3. In *Annex III Title II Part II Title II (8) Page 28* changes of the period on which the stressed VaR calculation is based must be notified ex ante to competent authorities. However, as stress-testing methodology already requires regulatory approval to be implemented, once it is approved, we do consider that changes in the 'stressed

period' should be notified ex ante, unless the change does not fit the approved methodology.

4. In accordance with *Annex III Title II Part II Title II (14) Page 28* changes in the implementation of internally developed and implemented pricing models or use of proxy models must be notified ex ante to competent authorities. However, pricing models are continuously being developed, so quantitative impacts and new changes would overlap and could not properly assess the materiality of each change. We propose evaluating the impact of changes on a basis given, and then evaluate the impact of all the changes made since the last notification.