BNP PARIBAS

EBA/CP/2013/02

SUBJECT: Comments on a consultation on Draft RTS on the conditions for assessing the materiality of extensions and changes of internal approaches for credit, market and operational risk

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We welcome the EBA intent to specify the conditions for categorizing extensions and changes of internal approaches which require authorization or notification, in order to foster more harmonized supervision.

The document is divided in two main parts where the first part contains general comments and the second part contains responses to the 18 questions.

I. General comments

In general, we support the efforts of harmonizing the conditions for assessing the materiality of extensions and changes of internal models.
We support as well the idea that some categories of changes may be communicated to the competent authorities with sufficient notice so that they can decide whether or not further investigation is needed.
However the framework proposed in the draft RTS raises some issues. The RTS proposal is very restrictive, burdensome and will contradict other regulatory objectives of responsiveness to external changes and models enhancements.
Because methodologies are developed and evolve to better measure risks and to adapt to an evolving environment, we believe that cases where implementation of models is delayed because an approval from the supervisor is compulsory should be very rare (i.e. limited to approach changes). Conversely, we understand that supervisors need to ensure, before the fact, that regulation is properly applied.
We would therefore welcome that the proposed piece of regulation include the possibility that, for significant changes, the supervisor decides case by case, on the basis of exchanges with the institution, whether a formal approval is necessary before implementation or not.
We notice as well that ex ante notification is sometimes requested when there is no model change (change in lending practice, change of data source, change in the organizational framework or in allocated resources, use in the day to day management…). Such situations could be very difficult to identify within complex organisations, to be quantitatively assessed and sometimes to even have to be delayed during the observation period by the supervisor.
An overall materiality threshold of the exposure/ RWA of the portfolio concerned should be contemplated in order to avoid submitting requests for approval on very small portfolios.

We are very much concerned as well with the impact study language used in the document and insist that impact studies are approximates and volatile by nature. No double run period should be made necessary by this piece of regulation.
Lastly the provision on assessing aggregate impacts of under the threshold changes from the last validation date appears unmanageable to deal with, especially if considered under a given a stable risk profile over the period.

In general, we are convinced that the proposed framework would induce very significant cost for institutions as well as for supervisors should it be implemented as it is. Based on the RTS proposal, we think that there will be for the credit risk about 5 notifications or approvals sent to the supervisor per month and for the market risk about 15 notifications or approvals per year.

A/Comparison between the current French communication framework and the RTS proposal:

The communication framework towards the supervisor, as described in the draft RTS proposal, is much stricter than the current French ACP circular 2011-I-10. The number of cases for which an extension or a change requires an approval is much higher.
In certain aspects, though, the RTS creates new possibilities. In the French ACP circular, only two levels exist: the formal approval and the notification ex post. There is no case of notification ex ante. This proposal in the RTS appears as a constructive way to diversify the communication to the supervisor.

B/Comments on the qualitative lists:

From our point of view, the list of categorization of extensions and changes contains weaknesses:

- Most of the changes displayed on a qualitative list would be considered as material, thus requiring formal approval. The qualitative assessment criteria requiring formal approval appears to be too wide.

- The qualitative lists do not mention certain cases (i.e. : where the change or the extension is made to meet a supervisor's recommendation)

- Regarding operational risk, the wording of the qualitative lists is, in some cases, not precise enough. Furthermore, most of the changes displayed in the qualitative list deal with the operational risk framework (change in organization, changes in the frequency or recipient of dashboards, changes in budget, ….) and cannot be quantitatively assessed. Thus they should not be covered by the quantitative threshold provision

- The level of communication (approval, ex ante notification, ex post notification) sometimes lacks consistency with the nature of the model change or extension. For example, 'the change in the data' (i.e. the price for market risk) requires an ex ante notification while this kind of situation is often due to the disappearance of a data provider, which is an independent event from the credit institution. To change a data source already is a complex process to organize. Adding an ex ante communication toward the supervisor before its implementation can only make it more complex.

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C/Comments on the quantitative assessment:

In the draft RTS proposal, a systematic quantitative impact is required. The way to perform it is not sufficiently clear under some aspects, not always relevant and too burdensome.

- The quantitative impact has to be performed on "the range of application" of rating systems. Does it mean the entity, the business line, the portfolio, the VaR or the IRC, regarding market risk ?
- With regards to changes to the AMA framework, as a lot of given items are qualitative, assessing the aggregate impacts on operational own funds appears difficult to achieve in practice.
- Regarding market risk, a quantitative impact needs to be calculated for all cases, whether they translate into a capital requirement increase or decrease. Limiting the impact calculation to the cases of capital decrease would prove more efficient from the Banks prospective. Furthermore, the required assessment period is too long (60 days). A much shorter period, such as 5 business days, would be enough to produce impact estimates with related conclusions.
- The impact analyses as described in the draft RTS will require significant and dedicated resources, unless best estimates are accepted as valid analysis. The implementation of these impact analyses will, then, imply significant (few millions of EUR) IT developments and dedicated departments within the Banks.
- The request that cumulative effect of minor changes be calculated is probably either not feasible at all nor at a reasonable cost. Yearly notifications of changes should reset the list and a grandfather clause should be introduced at the time of enforcement.

D/Comments on the combination of qualitative criteria and quantitative assessment:

In the mechanism described in the RTS which combines qualitative criteria and quantitative assessment, there is no room to apply a judgemental appreciation derived from these best practices. It has also to be noticed that the role of the independent review teams, which has been a long-time characteristic in the Banks model governance, is not mentioned in the RTS.

E/Documentation

Producing the documentation as it is described in the draft RTS would require significantly more resources.

F/The lack of information concerning the supervisor's answer:

No information or commitment is given regarding the timeframe for the answer from the competent authority, especially in the case of a formal request. Banks should be allowed to implement model changes if no answer has been received within a reasonable timeframe (as foreseen in some jurisdictions).

The competent authorities will have to be staffed adequately to be able to provide timely answers to the numerous demands. The stringent framework described in the draft RTS would saturate the competent authorities. The proposed framework should leave room for more flexibility, for instance by considering the judgmental appreciation in the assessment of the change materiality. This more flexible approach would provide an adequate role for the independent review teams.

The respective role of the home and the host regulators, especially when the host is not in Europe, has to be clarified.
The procedure does not touch upon the Banking Union, while it is expected that it will have a huge impact. The requests from the banks to the regulators will tend towards homogenization across Europe, but what about the answers from the regulators? Will they apply consistent guidelines to authorize banks to adjust their models?

G/Significant additional costs:

We anticipate mainly two sources of extra costs: formal documentation to competent authorities and the systematic impact computation.

H/ The impact on the model management and the use of the model

- Banks are required to respond as quickly as possible to economic change. They are also required to maintain internal models as risk-sensitive as possible. If however the regulator is not due to respond within a certain timeframe, the demand for reactivity to the economic environment cannot be met.

  For example, regarding credit risk, an economic downturn affecting a specific population could translate into the need for the LGD recalibration to maintain the relevance of the IRBA model. An approval from the regulator is then requested. If no clear deadline for the answer is stated, the bank will be forced to maintain an inappropriate model for a long period of time. As a consequence, the capital consumption could be significantly under-estimated compared to the actual risk.
- Too burdensome processes give the wrong incentive to banks, whereas they should be encouraged to continuously improve their internal models.

- The time frame it takes to receive feedbacks from the competent authorities would ultimately have negative consequences in terms of credit risk management given the operational use of the models

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II. Answers

The 'Answers' part is divided in five. The Part 1 is dedicated to the credit risk answers (Q1, Q2, Q3 and Q4), the Part 2 is about the operational risk (Q1, Q5, Q6, Q7 and Q8), the Part3 deals with the market risk (Q1, Q9, Q10, Q12, Q13 and Q14). Because of the specificities of each risk, the answer of the question 1 is split in the 3 parts. The part 4 is about the documentation (Q15). The last part deals with the costs arising of the draft RTS implementation for institutions (Q16, Q17 and Q18).

PART1: CREDIT RISK

Q1: Are the provisions included in this draft RTS that specify the principles of categorisation of extensions and changes, sufficiently clear? Are there aspects which need to be elaborated further?

We regret to observe that the RTS proposal is overly restrictive. It would be too much rigid in its philosophy:

- Most of the changes would be considered as material, as the proposal of qualitative assessment criteria appears to be too wide;
- the computation of quantitative impact analysis would be burdensome if best estimate are not accepted as valid analysis;
- the implied costs would be potentially substantial;
- as potential consequences:
    - o the time frame it takes to receive feedbacks from competent authorities would tend to be longer, which does not give any incentive to implement model changes and will ultimately have negative consequences in terms of credit risk management given the operational use of the models
    - o rating systems may lose their reactivity and fail to closely adapt to the changing economic conditions

<u>A/What is the role of the internal independent officers and validation teams in the draft RTS' process?</u>

It would be beneficial to place even greater reliance on banks' expert assessment and on banks' adherence to set up qualitative assessment conditions. Therefore, we highly recommend conserving the important role played by the bank-specific measures and banks internal assessment works by internal independent officers and validation teams.

<u>B/Consequence of the high frequency of the ex ante approval</u>

Globally, the implementation of this regulation will increase the frequency of ex ante approval from the regulator and therefore increase the time lag between internal approval of models and their implementation. Such situation will make the situation more difficult to understand for people using them on the field and, ultimately, alter the effective use of models for credit risk management.

C/Weaknesses of the qualitative lists:

Missing cases:

- The qualitative lists do not mention the cases where the change or the extension is made to meet a supervisor's recommendation (even in the event of an explicit agreement with the supervisor)
  - We recommend that changes undertaken by a bank to fulfil regulator's specific recommendations should not require approval prior to their implementation.
- Regarding credit risk, the draft RTS does not indicate the relevant communication to the supervisor when two entities approved under IRB Approach merge.

Definition of "the range of application" of rating systems (term used for classification of IRB approach changes):

There is no definition provided in the consultation paper. What shall it be: the entity; the business line; the portfolio, etc? We understand that "the range of application" means the portfolio on which a model shall be applied. Could you confirm?

Qualification of changes (Annex I):

Regarding Annex I-Part I & Part II – changes to be considered as material or they should be notified before implementation:

- Basically, we suggest that changes mentioned in annex I shall be classified as material or require ex ante notification, **if** the portfolio (to which the change is associated) shall also be considered as material or **if** the change itself is materiel (i.e.: definition of default).
- Some mentioned changes are rather related to, for example, the classification of prudential portfolios, the way of affecting counterparties from one business line to another. These changes should not concern the models validation method.

Issue regarding the classification of changes in data:

Firstly, we are convinced that data themselves don't necessarily imply models changes (significant or not).

Secondly, we all know that the data limitation issue is generally one of the key hindrances to the design and implementation of credit risk models. The reasons may be quite numerous: data availability; data supplier; the infrequent nature of default event; the longer-term time horizon used in measuring credit risk; available data sufficient to reflect credit cycle effects; data relevance to the business mix specific to each bank; etc.

For example, data appropriateness for current composition of the bank's portfolio is important in determining the soundness of internal models. The true factor which triggers the changes of a rating system should be the portfolio composition or business mix movement. It should not be the changes in data sourcing, use and data composition [as mentioned in Annex 1, Part II, Title II, (6)], which in turn have just adapted them as a consequence to the new profile of the bank's portfolio. Since modifications of the portfolio composition structure should've been assessed (already covered by

categories listed in Annex I), any assessment requirement related to data changes just creates useless redundancy.
In addition, the consultation paper did not address to the issue that certain data are in reality much less standardised across banks, across markets and national borders.

Our proposal:

Based on the above observations and necessary tradeoffs, regarding the classification of changes in data, we suggest to:

- Restrict ex ante notification requirement only to new data used to re-calibrate existing models: for parameter estimation of rating systems, and for return distributions representation of equity exposures. (Major data changes of all other natures should be reported after implementation, on an annual basis.)
    - Our rational: We find it more relevant to limit the ex-ante notification requirement to cases where any database recently created would be used for re-calibration purpose of existing and approved models. For cases where a new database is made up to build new models, if an ex-ante notification should be done before using the new database, that may lengthen the approval process and the deployment of the new model which in turn shall also be subject to a new application for approval.
- Exempt data changes from the quantitative assessment, to avoid redundancy.

<u>D/Comments related to Annex I - Quantitative criteria:</u>

- As set up respectively in articles 3 and 4, the concept of the quantitative criteria for assessing changes to the IRBA appears to be too strict. They need to be mitigated with an appreciation of the materiality of the portfolio concerned. Significant change of the portfolio's RWA should not necessarily trigger the necessity for prior approval if the portfolio concerned is small.
- On page 12, Article 2, § 3: The approach appears very theoretical. When non-material changes are implemented, it will not be feasible to measure the aggregated impacts of minor changes.

Q2: Are the provisions included in this draft RTS on the calculation of the quantitative threshold for the IRB approach sufficiently clear? Are there aspects which need to be elaborated further?

We find that the quantitative assessment criteria are overly strict (please also see our overall comments stated above.)

As clearly stated in the consultation paper (part 5, Technical decisions), it is expected that most of the extensions and changes to internal approaches subject to supervisory assessment should be identified in the first instance by qualitative criteria. Considering the philosophy of their very limited use, it appears even more difficult to understand the necessity to adopt quantitative criteria overly complex.
We believe that it's acceptable that the quantitative automatic assessment can be simplified and relaxed, provided that the bank's internal process and procedures for rating systems governance and validation are rigorous and working efficiently

From operational viewpoint, it appears very difficult to implement the quantitative assessment requirements. It would be very heavy and banks would not avoid a kind of “double run” situation: and on the other side for regulatory capital calculation; on another side for quantitative materiality thresholds assessment.

- It seems costly and without any foreseeable beneficit for banks and operators to manage a “double run”, especially for on a long-term basis.
- This kind of exercise may potentially create important operational risks (systems, etc).
- It would also generate considerable costs and request infrastructure resources that would be necessary in order to support these requirements.

In addition, we raise hereafter several issues:

- Situations where simultaneous changes in PD and LGD are quiteencountered met. If we need to change PD and LGD at the same time, how shall we assess impacts of the change: taking into account the PD/LGD cumulative effect; or only assessing each parameter’s impact individually?
- Making reliable impact study is very complicated on Corporate portfolio (expert data are often missing). In the case of Retail portfolio, it would be necessary to build a specific IT environment and to collect a lot of information, of some of which may be missing.
- Descriptions between Article 3-§1-(c)-(i) and Article 4-§1-(a)-(iii) changes: It is not clear enough to understand the exact definitions and their differences.
    - Article 3-§1-(c)-(i): The perimeter of the calculation is not clear. What happens for a model used in several entities of a banking group (principle of uniqueness of the rating for example, servicing activities)? How should the impact be calculated (for example taking into account the total perimeter of application of the model)?
    - Article 4-§1-(a)-(iii): we understand that the perimeter described here is not comparable with the one in article 3-§1-(c)-(i). There is no equivalence of perimeters between the two articles. We suggest using the same wording to increase clarity on calculation perimeter.

Q3: Do you support the calculation proposal of the quantitative threshold for the IRB approach in terms of design of the metrics and level of thresholds? (Please also take into account the arguments provided in Tables 2 to 5 of the Impact Assessment)

We do not in favour of the proposed calculation.
The quantitative impact has to be performed on ‘the range of application’, but the draft RTS does not provide a definition. Does it mean the entity, the business line, the portfolio?Solo consolidated?

The materiality of the portfolio itself is not addressed. Indeed, the threshold of 15% may be reached by changes on non-material portfolios. It implies that the permission / authorization will be required even on very small portfolios, which sounds difficult to manage.

Q4: Do you support for the IRB approach the three month period for notification of the changes before implementation?

The three-month period will only increase the time period between the beginning of the development and its implementation. A one month period for notification of changes would be more relevant.

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PART 2: OPERATIONAL RISK

Q1: Are the provisions included in this draft RTS that specify the principles of categorisation of extensions and changes, sufficiently clear? Are there aspects which need to be elaborated further?

As there is a wide range of models relating to operational risk measurement, this Regulatory Technical Standards is useful in order to provide consistent and harmonized rules for model changes or extensions. If we agree on the overall principles, we would like to point out a few issues in terms of understanding & implementation. Operational risk modelling is indeed a recent practice and is not suitable to some of the specific requests that are addressed.

1. There is a need for a distinction between quantitative (model by itself) & qualitative (global operational risk framework & governance) changes for assessing the compliance with quantitative threshold that is proposed. Items which do not have a direct impact on own fund requirement cannot be quantitatively assessed and consequently should not be covered by the quantitative threshold provision.

Furthermore, AMA extensions are already covering by specific and quantitative rules for qualifying to an approval process or not. We see not added value to submit them to another global threshold.

2. If we understand the concern of the supervisors of avoiding slicing changes or extensions to keep them under the threshold, the proposed mechanism appears almost impossible, to implement at least for operational risk. Yearly notifications of changes should reset the list and a grandfather clause should be introduced at the time of enforcement.

3. A few quantitative items seem to be better adapted to models mainly based on historical data rather than scenarios. Indeed, notifying any change in a scenario or any scenario creation/removal would be an administrative task that would add no value to supervision and create sluggishness in the risk sensitiveness of the model.

Q5: Are the provisions included in this draft RTS on the calculation of the quantitative threshold for the AMA sufficiently clear? Are there aspects which need to be elaborated further?

Art. 2 - § 2 : We agree with the principles. But as far as operational risk is concerned,

- The provision of the text covers properly the extension topic with different and clear thresholds defined, all of them more restrictive than the quantitative general threshold (but the aggregate impact clause, see below) which thus appears useless.

- The provisions of this article should only apply to changes with a clear and direct impact on own fund requirements, that is A2 Part II, tittle 1 (2) & (4)and Title II (4) & (6).

For instance, some changes are related to qualitative items, such as the positioning of the independent risk function or to the resources allocated to the corporate risk function. There is no reasonable quantitative assessment possible for this kind of changes.

Art 2 – § 3 : As a general comment, if we understand the concern of the supervisors of avoiding slicing changes or extensions to keep them under the threshold, the mechanism considered appears globally extremely difficult to implement, at least for operational risk.

1. How should we understand “triggered by the same underlying reasons”? Should a reason be understood as a § in Annex 2 for instance ?

   If we have to follow the impacts per reason, it will be practically unmanageable for the institution, nor controllable by any auditor.
2. Should we understand the marginal change or extension, even if minimal, will be subject to permission or a priori notification? For instance and considering extension is a reason, if several AMA entities of reduced size have been subject to an AMA roll out over the years, should the last small entity that will make the 10% threshold be reach, be subject to permission ?

3. More fundamentally, we do not understand the rationale of this mechanism for AMA extension. As per annex 2, part 1, title I (5) and title II, and part 2, title I (5) and title II (8), we consider the supervisor has already a strong and sufficient monitoring of extensions[1]. Furthermore AMA extensions are to be done per legal entity. There does not seem to be ways to play with the rules.

4. As regards changes to the AMA framework, as a lot of the items given in Annex 2 are qualitative, we do not see how to assess the aggregate impacts on OR own fund requirement (see previous comment on Art. 2 - § 2).

5. The starting point for performing this assessment is said to be the “last internal validation process”. Is there a grandfather clause at the date of the enforcement of this regulation ? If not, it will appear to be unmanageable.

Q6: Do you support the calculation proposal of the quantitative thresholds for the AMA in terms of design of the metrics and level of thresholds? (Please also take into account the arguments provided in Tables 2 to 5 of the Impact Assessment)

We understand the regulator would like the determination of the impact be free of any other effect (especially change in the risk profile) than the one to be assessed. This may be reached with a reasonable insurance of relevance if done on a one time basis and at the time the decision for materiality is taken (for instance assessing the impact of an extension by just adding the data of the new entity to the data currently used without any changes). This is impossible to perform with respect to assessing aggregate impact of successive changes (see Art 2 - §3).

Annex 2 Title II – (1) – (a): The provision about a change in the external Data source should be limited to model where external data are used as a direct input.

Annex 2 Part II, Title II – (1) – (b): The wording is far too imprecise and general. As a general statement, we do not consider the regulators should enter in such a level of details, being it before and even after implementation notification.

[1] What the provision would try to cover is the case whereby the institution has rolled out along the time (potentially years) AMA on several entities, each individually accounting for less than 1% of the OR own fund requirement at the time of extension, and that by the end, all these extension would make for more than 10 % of OR capital at the time the last marginal extension is considered. The interest of this case appears minimal.

Annex 2 Part II, Title II – (2) – (a): The considered changes in the duties & responsibilities should be significant, i.e reduction or extension in scope to require a before implementation notification.

Annex 2 Part II, Title II – (2) – (b):

1. Budget and headcount should be defined in order to ensure consistency across institutions. Especially are IT costs and headcounts to be considered and to which extent (development? IT production?)

2. The starting point, i.e. the last approval does not seem to be an appropriate reference point. Furthermore, no consideration is made for monetary erosion.

We propose that standardized resources figures be notified on a yearly basis and that the last information provided constitute the reference point.

Annex 2 Part II, Title II – (4) – (a) – (v): The case here mentioned appears to be linked to some kind of models but should not be a general statement. It concerns models based on historical data and not the ones based on scenarios. Notifying every change (upward or downward) in a scenario (which may be considered as a risk cell) would be an administrative task that would add no value to supervision and create sluggishness in capital adjustments to events.

Annex 2 Part II, Title II – (5) – (a) – (i): In practice, large institutions define maximum thresholds individual entity should comply with, while having the possibility of setting lower thresholds if relevant. The provision of this § should only apply to the group wide maximum threshold and not the individual thresholds.

Annex 2 Part II, Title II – (5) – (b): The wording is far too imprecise and general. The notification should be limited to the validation process regarding scenarios.

Q7: Do you support for the AMA the three month period for notification of the changes before implementation?

Yes

Q8: Do you support that for the AMA no quantitative differentiation between changes requiring notification prior vs. post implementation is made?

Yes

PART 3: MARKET RISK

Q1: Are the provisions included in this draft RTS that specify the principles of categorisation of extensions and changes, sufficiently clear? Are there aspects which need to be elaborated further?

Overall, the proposed regulatory standards are relatively clear. In some areas, more precisions could be provided. For instance no definition is given to "the scope of application" for the quantitative assessments. Also, we would like the standards to clarify the timeline of the extensions and changes implementation, in particular with respect to the amount of time granted to the Competent Authority to respond to request of permission or notifications. The interaction between Home and Host regulators in this context should also be clarified.

- **A/Delays due to the quantitative assessments**

The proposed quantitative assessment of extensions or changes for market risk internal model approaches are based on 60 days impact measures. As a quantitative assessment is contemplated for all extensions and changes, even those anticipated to be of minimal effect, any implementation will be delayed by at least 3 months.

We believe that such a long period of quantitative assessment is unmanageable. The number of contemplated extensions or changes will have to be scaled back to as little as 4 a year. A much shorter **period of 5 business days** is enough to produce impact estimates with adequate precision.

Besides, some extensions or changes are of very limited impact. They should not require a full scale impact assessment. Instead, some point in time estimates should suffice. Those extensions or changes should only be reported on an annual basis, irrespective in which descriptive category they fall into (for extensions type deemed material (Part I, Title I), a notification on implementation could be envisaged). The threshold of quantitative immateriality could be set to 1% of the Group level own funds requirements for market risk.

Other extensions or changes should be considered out of scope of this regulation. **Out-of-scope extensions or changes** comprise:

a) Bug fixes.
b) Changes made at the request of the Internal Independent Validation Team.
c) Extensions or changes demanded by the competent authority.
d) Re-calibration of internal models parameters (correlation matrices, etc…).

Additionally, to minimise overheads while still fulfilling the bottom line of the regulation, multiple extensions and changes implemented simultaneously should require one single quantitative assessment without necessarily trying to isolate the impact of each extension or change individually unless deemed relevant by the institution.

Finally, the thresholds set forth in the proposed regulatory standards should only apply for extensions and changes that lower own funds requirements.

- **B/Delays due to the procedures**

For extensions or changes that will be considered as material, either because of their nature, or they belong to one of the extensions or changes listed in Annex 3, Parts 1 or 2, Title I, or they result in a breach of one of the quantitative thresholds of Article 7, paragraph 1(c), and will as a consequence require a permission from the Competent Authority, the delay will, in fact, be much longer than the 3 months highlighted in the previous section. The proposal sets indeed no deadline to the Competent Authority to grant or refuse authorisation. In case of multiple authorisations requested (Home/Host), the situation is even less clear. The result will be for institutions uncertainty on the potential application date of their proposed extensions or changes as well as prolonged delays.

For example, according to Article 5 of ACP Instruction n°2011-I-10, extensions or significant evolutions of internal models involving a mother company and its subsidiaries within the European Union are governed by Article 129-2 of the 2006/48/EC directive. The latter states that the Competent Authorities – Home and Host – have up to 6 months to produce a joint decision. Such delay would introduce unacceptable frictions in the evolutions of the risk management.

In this respect, we would suggest that the regulatory standards set a schedule for the Competent Authority in their assessment of material extensions or changes (those that require approval before implementation), clearly articulating the timeline for both Home and Host regulators. We believe that a period of 1 month for the Competent Authority to respond would be reasonable, potentially extendable to a maximum of 2 months upon notification.

As for the extensions and changes of relative significance for which a one month prior notice is required under the proposed regulatory standards, we consider that this advance notice adds an unnecessary delay to their implementation considering that the institution must have received prior approval from the Internal Independent Validation Team in application of Article 358. If this independent approval is granted, we believe that the implementation should be allowed to proceed at the same time than we submit to the Competent Authority a notification.

To smooth extensions or changes implementation processes, we suggest that is considered the possibility for the Competent Authority to give its authorisation ahead of time if ongoing constructive exchanges with the institution have demonstrated to the Competent Authority the soundness of the planned extension or change.

- **C/Proposal for an effective and responsive set-up**

The regulation should conciliate an effective and thorough assessment of extensions and changes on one hand with the necessary responsiveness of internal models to changes in markets conditions, portfolios structure or new market products on the other hand. To achieve those two goals, the regulation should:

e) **Leverage on the Internal Independent Validation Team** works which include assessment of all extensions and changes before their implementation.
f) Require a prior authorisation from the Competent Authority only in those circumstances that are really material both by their nature and by their impact on own funds requirements.

g) Allow for other significant extensions and changes to be implemented with no delay with a concomitant notification to the Competent Authority.

h) Require only annual notification for extensions and changes with minimal quantitative impact irrespective of the category they fall into.

i) Allow for pre-approval through a continuous constructive dialogue with the Competent Authority.

j) Leave out of scope of this regulations extensions or changes made at the request of the Internal Independent Validation Team or the Competent Authority as well as bug fixes.

The table below summarises the set-up of the extensions and changes assessment which in our view would meet the purpose of the regulation while still being adapted to the reality of market evolutions and risk management constraints.Assessment of materiality

<table>
<tr><td colspan="2"></td><td colspan="7">Qualitative criteria</td></tr>
<tr><td colspan="2"></td><td colspan="2">Material</td><td colspan="2">Non-material but significant</td><td colspan="2">Other non-material</td><td>Out of scope</td></tr>
<tr><td colspan="2"></td><td>Extensions
Annexes Part I Title I</td><td>Changes
Annexes Part II Title I</td><td>Extensions
Annexes Part I Title II</td><td>Changes
Annexes Part II Title II</td><td>Changes</td><td>Extensions</td><td>Bug fixes
Independent office recommendations
Competent Authority demands</td></tr>
<tr><td rowspan="3">Quantitative assessment</td><td>Immaterial</td><td>Notification on or after implementation</td><td>Notification after implementation on an annual basis</td><td colspan="2">Notification after implementation on an annual basis</td><td colspan="2">Notification after implementation on an annual basis</td><td rowspan="3">Notification after implementation on an annual basis
Re-calibration of market parameters are part of IM procedures and do not, in this context require additional disclosure</td></tr>
<tr><td>Below the materiality thresholds</td><td>Notification before or on implementation</td><td>Notification on or after implementation</td><td colspan="2">Notification on or after implementation</td><td colspan="2">Notification after implementation on an annual basis</td></tr>
<tr><td>Above the materiality threshold</td><td>Request of permission before implementation</td><td>Notification before or on implementation</td><td colspan="2">Notification before or on implementation</td><td colspan="2">Notification on or after implementation</td></tr>
</table>

- **D/Quantitative assessment scope**

The proposed regulatory standards require that the quantitative assessment is performed both at the consolidated level and at the level of the scope of application. However no definition is provided regarding the scope of application.

In our view, the scope of application should be one of the capital measures, VaR, stressed VaR, IRC or CRM, in its entirety. A further split by individual desk will be both irrelevant and costly in term of workload.

- **E/Quantitative assessment measure**

We have advocated above that basing the quantitative assessment on 60 days impact calculations would delay implementation of extensions or changes by too long. In addition, 5 days should be amply sufficient to accurately assess the impact. Importantly too, running during 60 days parallel calculations of own funds requirements will be very costly for institutions.

Regarding the quantitative assessment at the scope of application, we do not understand the motivation behind the use of a maximum rather than an average impact. As for the impact assessment at the consolidated level, an average would lead to a statistically more meaningful measure.

We like to stress again, that only extensions and changes resulting in a decrease of own funds requirements should be weighed against the thresholds. An increase in own funds requirements should not trigger a breach of the thresholds.

- **F/Qualitative criteria**

Some allocations of extension or change types within the material or the non-material yet substantial categories are questionable.

k) Change of data sources [Annex 3, Part II, Title I, §(4)] should not be considered a material change. In itself, they do not imply necessarily a change of model. Only the changes to the internal model, which might result from a change of data sources, should be taken into account for the categorisation. Besides, data sources might be changed due to a discontinuity in data availability from an external provider. Delay in implementing the changes of data sources and the necessary adaptation of the internal model should absolutely be avoided to ensure the integrity of the calculation of the own funds requirements.

l) Bug fixes should left out of scope of this regulation. As such, and unless anticipated to have a significant impact, they should only be required to be notified on an annual basis.

m) Implementation of internal independent validation teams' recommendations should be exempted from any prior authorisation or advance notification.

n) Likewise for the Competent Authority recommendations. Their implementation should only require immediate or annual notification, depending on the significance of the extension or change, with, in addition, no need to keep open the roll-back possibility in this case.

Q9: Are the provisions included in this draft RTS on the calculation of the quantitative threshold for the IMA sufficiently clear? Are there aspects which need to be elaborated further?

The proposed regulation does not provide a definition of the scope of application. We believe that anatural scope of application that will make sense and be manageable would be the capital measure, i.e. VaR, stressed VaR, IRC or CRM.

Q10: Do you support the calculation proposal of the quantitative thresholds for the IMA in terms of design of the metrics and level of thresholds? (Please also take into account the arguments provided in Tables 2 to 5 of the Impact Assessment)

We do not support the 60 days average (see Q 12). We also question the use of a maximum rather than an average for the metrics of the scope of application. Finally, we would like the regulation to introduce a level of immateriality (say 1% of the Group own funds requirements for market risk) below which any extensions or changes will require only annual notification.

Q11: Do you support for the IMA the one month period for notification of the changes before implementation?

We believe that a notification on release should be sufficient. A month prior notification will bring no benefit and will unduly delay extensions or changes. We believe that a Competent Authority should leverage on the Internal Independent Validation Team authorisation processes rather than duplicating it. If however, subsequently, the Competent Authority rejects an extension or change, it could issue a recommendation within the usual supervisory framework.

Q12: Do you support for the IMA the 60-day observation period for the purpose of comparing the modelling result before and after a proposed change?

We believe that a 3 months period to perform IMA quantitative assessment is both too long and unnecessary. A reasonable period for the assessment is 5 days, or even point in time for low impact extensions or changes.

Q13: Do you support that for the IMA for those modelling approaches which are only required to be calculated once a week (stressed VaR, IRC, CRM) to compare only twelve numbers for Article 7 paragraph 1(c)(iii)?

For models requiring only weekly calculation, the assessments could again be made on a 5 measures average allowing for point in time assessments for smaller extensions or changes.

For institutions performing the calculation daily, even though only weekly figures are used for the own funds requirement, the assessments could be done on 5 consecutive days average.

Q14: Do you support that for the IMA no quantitative differentiation between changes requiring notification prior vs. post implementation is made?

As reported at Q10, we support the introduction of a level of immateriality below which only annual notification is required in all circumstances.

As we do not see the benefit of prior notification and believe that on implementation notification is sufficient, there is no need for such a distinction.

- **PART 4: THE DOCUMENTATION**

Q15: Are the provisions included in this draft RTS on the documentation requirements sufficiently clear? Are there aspects which need to be elaborated further?

- The independent reviews for all models validation are supposed to be reported for approval or ex ante notification, which further increase the existing substantial workload carried put by the internal validation teams.

Some points have to be clarified:

- Article 9, 1-**h**: We are questioning the usefulness of the documentation requirement stated "*record of the institution's current and past version of internal models*". The record of past version would be of limited interest if it’s not detailed enough. However, Handling it will be extremely burdensome if banks should provide all documents related to all past models (as they should be no longer in use). Just to give an idea about what we do today with French regulator, we are required to provide a summary of all past changes occurred. We think this kind of yearly summary is sufficient enough and works in an efficiently way.

- Article 9, 1-**b**: it should be specified as implementation date “target / expected”.

- Article 9, 1-**g** *quantitative impact*. It should be specified as quantitative impact “when available”.

- Impact studies are not perfect. Regulators should be aware that they are based on hypothesis. The impact measurement is often carried out by assuming a constant portfolio (invariable scope and parameters, except the factor of which we seek to measure the impact). However, the implementation of the modified model will take place on a more or less distant future date on a portfolio which would have changed.

- PART 5: COSTS ARISING OF THE DRAFT RTS IMPLEMENTATION FOR INSTITUTIONS

Q16: Do you support the view that costs arising for institutions from the documentation requirements included in the draft RTS are not expected to be material? If not, could you please indicate?

- the main cost driver: i) additional IT equipment, ii) additional ongoing Staff/hours, iii) other (please specify).

- The % increase in total yearly costs of internal models management for credit/operational/market risk induced by the proposed documentation requirements (specify whether the costs arise only for some of the risk categories covered by the provisions).

- Indicative monetary amount of these additional costs (specifying currency and unit)

Globally, the volume of requested documentation is too burdensome for banks.

We feel that the costs will be material, essentially in terms of:

- Additional staff costs: It will be obviously more costly than the effort done for a first agreement of the model, as for example, the entity will have to provide a comparison study with the old model...

- Much more PMO coordination activities needed: The costs would also be consequent, as the process will concern many actors from several functions of a group and much more coordination activities would be necessary (reporting, model, IT, business lines, etc.). It can also affect other entities within the group if the documentation concerns the whole application perimeter.

Q17: Do you support the view that the additional costs, for institutions, of computing the quantitative impacts of the implemented model extensions/changes are expected to be non-material, given that institutions already carry out impact analysis in the current framework? If not please indicate:

- the main cost driver: i) additional IT equipment, ii) additional ongoing Staff/hours, iii) other (please specify).

- the implied % increase in total yearly costs of internal model management for credit/operational/market risk induced by the quantitative impact analysis (specify whether the costs arise only for some of the risk categories covered by the provisions).

- indicative monetary amount of these additional costs (specifying currency and unit).

We feel that the costs will be material, in particular, in terms of:

- Considerable IT costs to produce impact studies: Our resources available in current infrastructure clearly cannot face to all these increased requirements. Banks will face to the problem of IT infrastructure's current capacity, as well as regulators who would also have to enhance IT infrastructure capability.

  Regarding the market risk, we anticipate that the cost of computing full scale impacts on all changes will be very costly. It will require the setup of a new environment replicating in its entirety the live production environment. It will be a doubling of our IT equipment.

- Additional staff costs: To service this new environment, additional staff will be required, in number equal or nearly equal to the number of staff servicing the existing live environment.

- Much more PMO coordination activities needed: The costs would also be consequent, as the process will concern many actors from several functions of a group and much more coordination activities would be necessary (reporting, model, IT, business lines, etc.). It can also affect other entities within the group if it concerns the whole application perimeter.

Q18: Do you support the view that, for institutions, the costs of ex-ante/ex-post notification of extensions/changes are expected to be non-material? If not, please indicate:

- the main cost driver: i) additional IT equipment, ii) additional ongoing Staff/hours, iii) other (please specify).

- the % increase in total yearly costs of internal models management for credit/operational/market risk induced by the notification requirements (specify whether the costs arise only for some of the risk categories covered by the provisions).

- an indicative monetary amount of these additional costs (specifying currency and unit).

- The cost associated with the submission of extensions and changes before implementation for authorisation as well as ex ante or ex post individual notification is expected to be high in particular in relation with the amount of documentation. It will come on top of the additional cost incurred due to the full scale quantitative impacts (see Q17).
- But more importantly, it will also increase very significantly the workload on Competent Authorities. If the proposed regulation remains as it is, Competent Authorities will face a large amount of request for authorisation and even more for notifications. We estimate that, for a single institution, a Competent Authority will receive for market risk alone double digits prior approval submissions
- In case of ex-ante notifications: we may potentially have to make modifications to the model presented, subsequently to the notification, for which costs on new developments would be generated as well.