



10/06/2013

EBA-CP-2013-02@eba.europa.eu

Consultation paper on draft regulatory technical standards on the conditions for assessing the materiality of extensions and changes of internal approaches for credit, market and operational risk

The Swedish Bankers' Association welcomes the opportunity to comment on the consultation on the draft RTS on internal approaches for credit, market and operational risk. As a member of the European Banking Federation (EBF) we support the EBF response to the consultation. Nonetheless we would like to make some additional comments.

General remarks

- We support the establishment of clear standards and common European rules in this important area.
- However, we believe that the EBA proposal puts too much emphasis on the quantitative identification and documentation. This will cause a very rigid approval framework and will increase the complexity of – and slow down the process of – the continuous efforts of banks to improve models according to evolving risk management needs and develop them to cater for new business initiatives.
- One of the primary tasks of a bank's risk management department is to make sure that the bank's market risk models are always appropriately reflecting the real risk of bank's portfolios. Therefore, model improvement initiatives will be on-going at all time. Requiring that the implementation of such improvements be delayed by 60 days to confirm that their quantitative impact does not exceed a certain threshold, and then an additional 30 days to allow the supervisor to consider the prudence of the proposed change, is in fundamental conflict with the necessary agility of such a governance process. One potential consequence of this would be for banks to operate a dual model set-up: one model for their own risk management purposes and one model for regulatory capital, but such an approach seem to challenge the use test requirement.



- A premise for the draft RTS seems to be that banks' implementation of model changes is, in general, a sequential process where a bank focuses on the development of one model change at the time, but this is not the way banks' model development works. Rather, banks will work on any number of minor, and occasionally major, improvements at any time and the speed of development can be difficult to predict at the outset. Some development processes will be quick, while others may take longer than expected. A requirement that banks must be able to rigorously quantify not only the isolated effect of one potential change, but also its combined effect with other potential changes adds a lot to the complexity of the process. At any point in time it may not even be clear which combinations of model changes it is relevant to consider.
- Banks make model changes in order to improve models. For market risk, the micro-managing approach taken in this draft RTS serves to disincentivise this activity. A markedly different approach to supervisors' involvement in the model change process, which we would favour, would be for supervisors to increase their focus on evaluating the soundness of banks' governance of model changes, and require only material model changes to be approved by the national supervisor. I.e. in the framework of this consultation document, this would be tantamount to increasing the quantitative threshold for material changes; abolishing the proposal to have banks notify supervisors of immaterial model changes in advance; and significantly reducing the number of, and scope of, qualitative criteria in annex 3 that entail that a model change is to be considered material.
- We find it cumbersome as well as irrelevant to supplement all applications for material extensions and changes with a detailed plan for all (other) exchanges and changes planned for implementation over the next 12 months.
- Producing the documentation required for a formal application to the regulatory authority requires resources. We believe that producing formal applications to the supervisors requires significantly more resources not only in formulating the application, but also in the dialogue phase while the application is being processed and therefore it will draw heavily on resources in both institutions and supervisory bodies. Also for the notification process, documentation will be needed as support. We are concerned regarding the competent authorities resources: will they be able to manage the inflow of notifications in timely manner.
- Regarding the substance of the provisions it is not clear if there is any room for interpretation by the competent authority.
- The principle of materiality opens up for interpretation.
- The timeframe for implementations of changes in the internal approaches requires the competent authority to act within a certain time, however there are no such provisions in the CRR or the draft RTS.



- Extensive analysis will be required also for minor changes. This is resource demanding both in terms of personnel and IT. It also risks to dramatically slowing down the process of making gradual model improvements.
- Regarding notifications only ex ante notifications are regulated. Extensive analysis will be required to determine whether the notifications are to be ex post or ex ante. Therefore it would be more appropriate to either require general notification or only the ex ante alternative.

Questions for Consultation

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?

No, it is not sufficiently clear for which models this RTS is to apply. Does this RTS only include IRB, AMA and IMA or does it also include other internal model (e.g. the Internal Method Model for Counterparty Credit Risk)?

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?

No, the 15% threshold is not sufficiently clear for us. It needs to be further elaborated on what portfolio/consolidated level the calculation should be done.

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)

The quantitative threshold on group level is appropriate, but the supplementary sub portfolio level is not appropriate as it open up for many border line issues. In fact, any portfolio in scope could be limited to a level where the threshold always will be a problem.

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)

The levels are too low. Especially 1(c)iii as it only require one single day during the 60 day period to exceed the 10 % threshold. Also, the requirements are problematic when it comes to materiality, for example organisational changes.



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?

Yes they are clear.

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)

No, we do not support the thresholds. A threshold of 10% change in the model calculation result in a risk measure seems quite low. We would expect that the majority of model extensions and changes (including many of the extensions and changes mentioned in appendix 3 part I, title II and part II, title II) would trigger this threshold and thereby be categorised as material. Further, the analysis required for minor changes to ensure that no thresholds are exceeded would be extensive. We believe that there should not be a threshold for the specific IMA model. The relevant effect to consider should be the change in capital requirement as a percentage of a bank's total capital requirement for market risk. And given the volatile nature of IMA charges, this threshold should be 10%, not the proposed 5%. A 5% threshold would imply that too many model changes of non-material nature were to be treated as material vis-à-vis national supervisors. Not only would this be an undue burden on banks, but supervisors would also risk being faced with spending considerable resources on these processes. This would also slow down the process of making gradual model improvements.

For some banks, some of the specific risk IMA models produce charges that are trivial compared to the total capital requirements of the bank. Therefore, if EBA does decide to keep the 10% threshold, our proposal would be to complement it by another threshold on the effect of the bank's total capital requirement (for all risk types) of e.g. 0.25%, where both thresholds should be exceeded in order to trigger a process vis-à-vis the national supervisor according to the approach for material changes.

Further, that just one of sixty calculations exceeding a 10% change should trigger a process vis-à-vis the supervisor according to the approach for material changes seems excessive. Will supervisors be ready to deal with the ensuing significant increase in the number of application for model changes?

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

No, we do not support the one month period for notification. To ensure that banks are able to react with appropriate promptness to risk management needs and



business initiatives, it is our belief that all non-material extensions and changes should be subject to ex-post notification requirement.

The one month period unduly slows development of model improvements. Also, occasionally banks will discover undesirable features, or even errors, in their models. A one month delay in implementing such a correction would be highly unfortunate.

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?

No, we cannot support the proposal for a 60-day observation period. We find it reasonable to base an impact assessment on several observations, but a 60 day period seems unnecessary long and burdensome. An impact assessment based on 60 days in a row does not provide a representative test period. Furthermore, the 60 days impact assessment could give a false impression of a model robustness which might not be accurate. It will also delay the implementation of changes and hamper institutions ability to implement risk management improvements in a timely manner. Further, it is our opinion that an impact assessment based on an observation period of the last 60 days does not necessarily provide an assessment of the model's soundness and reliability. Rather, we propose, as an alternative, to require banks to document a sound model validation of the proposed change. The purpose of such a model validation would be to provide the assurance that the supervisor would need in order to feel confidence in the soundness of the modelling choices, and would naturally contain an impact study based on observations in different 'financial climates', not just the most recent data. The impact study should be allowed to be based on some simplifying assumptions, provided that the simplification is obviously reasonable.

Should EBA decide to keep the 60-day observation period, it is unclear how a bank is to carry out impact assessment for improvements running in parallel. Should each improvement be assessed separately during the 60-days period, or should they run in consecutive periods?

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)?

An assessment based on 12 weekly observations will, in line with the 60 days period mentioned under question 12, hamper institutions ability to implement risk management initiatives in a timely manner.



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

Our proposal is that there should be only one category of immaterial change and that should be only ex-post notification.

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

It is our general view that the required documentation is excessive. It is unclear what exactly is expected to be the content of the documentation of the scope of application affected by the model extension or change. It is also unclear what kind of documentation institutions are expected to present as response to article 9, item 1,h? Please specify.

The requirement to present the planned changes for the coming 12 months also needs to be clarified. To what extent are institutions committed by what they have previously reported? Does this imply that institutions cannot introduce changes not previously presented in their twelve months plan?

Our view is that it should be clearly stated that the information does not prevent banks from changing priorities if there are good risk management or business initiative arguments for this. Also, it should be clear that the twelve months' plan is only in terms of 'headlines' so as to minimize the administrative burdens on banks.

It will significantly reduce the ability to react to changes in financial markets since plans can change rapidly due to changed market conditions and changed market practice. It could increase the gap between risk model used for internal risk management and the models used for regulator purpose, since institutions will not be able to implement changes when needed.

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:

No, we believe it is fair to assume that the additional costs of computing the quantitative impacts and associated with impact analysis on extensions and changes both to the IRB framework and the IMA framework will be material. In particular, the requirement to have a 60 day quantitative impact study will lead to a substantial increase in IT costs as it will necessitate a considerable upgrade of system capacity. Also additional costs associated with ex-ante/ex-post notification of extensions/changes will increase significantly. We fear that the increased bureaucracy will drain resources from other risk management needs.



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

No, the costs of computing of the quantitative impacts will be material. The additional cost will be driven by increased IT- and human resources. A rough estimate of the proposed RTS' impact on IT costs for operating IMA would be a 100% increase. Further, a considerable increase in staff costs would also be likely to ensue.

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