

THE ECB TRIM AND THE REVISED STANDARDISED APPROACH: FORWARD-LOOKING THEMES IN CREDIT RISK MANAGEMENT

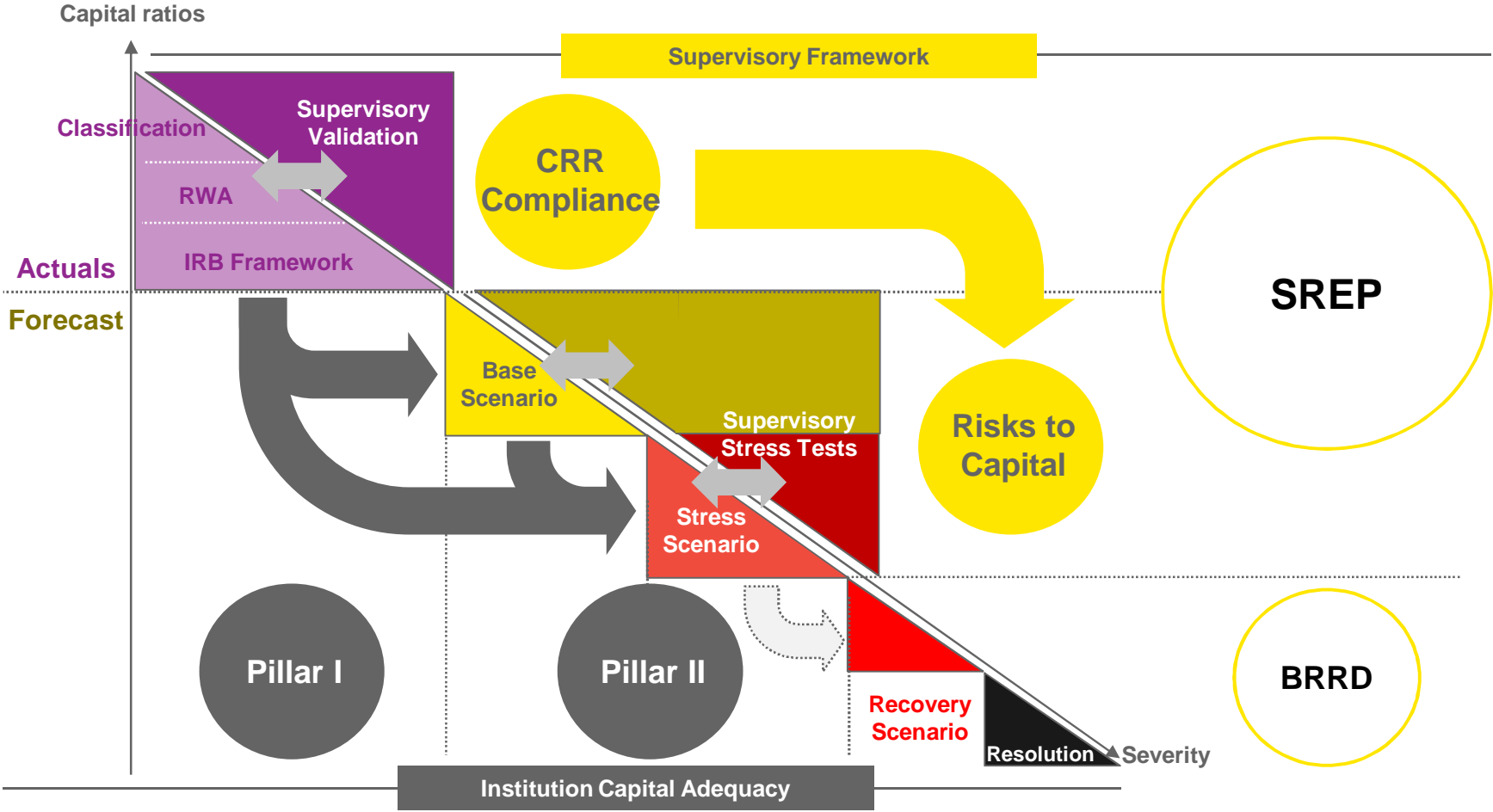
June 2016



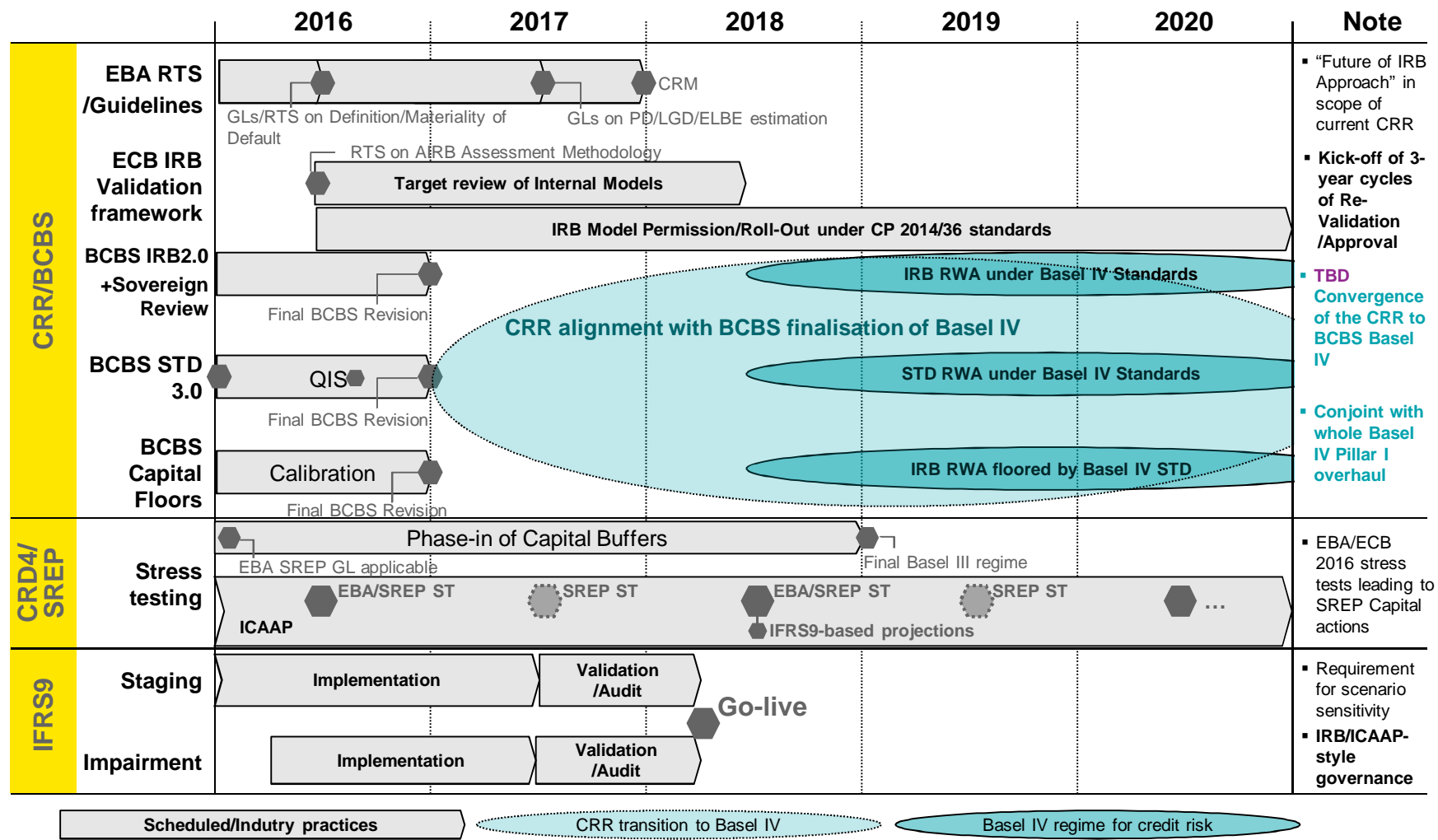
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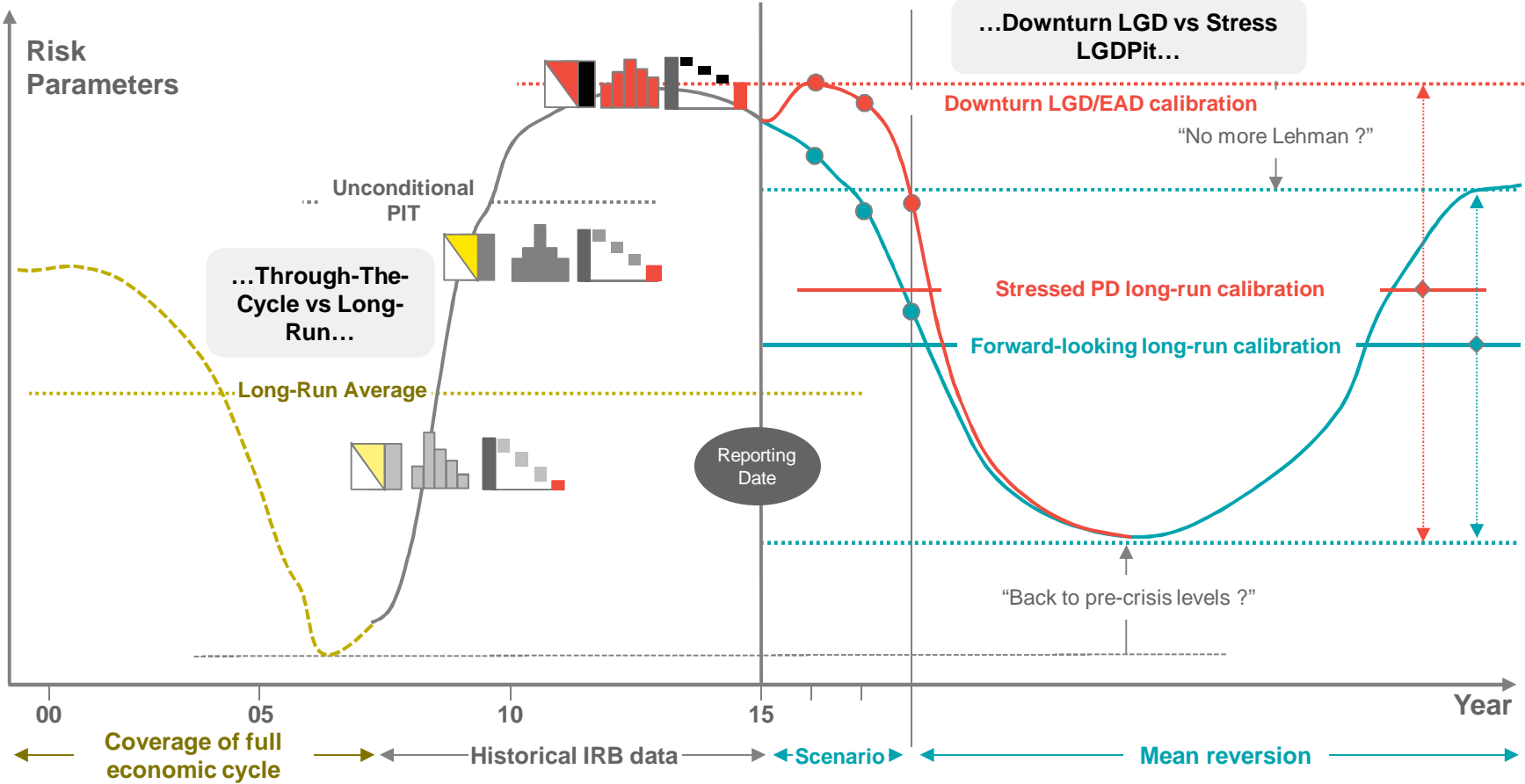
Capital Adequacy and Provisioning Basel III, Basel IV and IFRS9



The IRB Approach

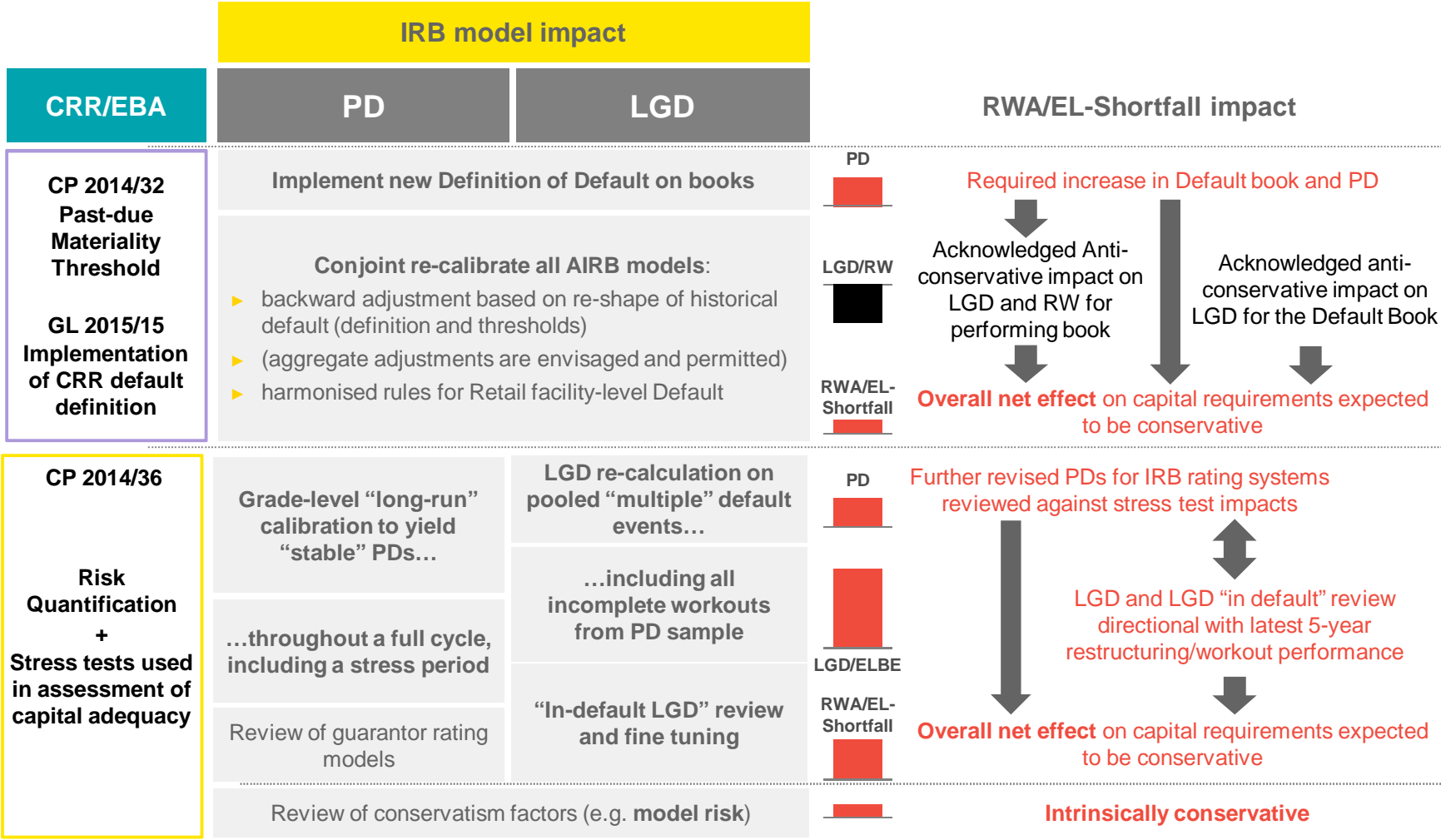
A re-stated forward-looking view...

EBA CP 2014/36 re-states the requirement for a **forward-looking long-run calibration** of IRB parameters aimed at achieving **stable risk estimates through stress**.



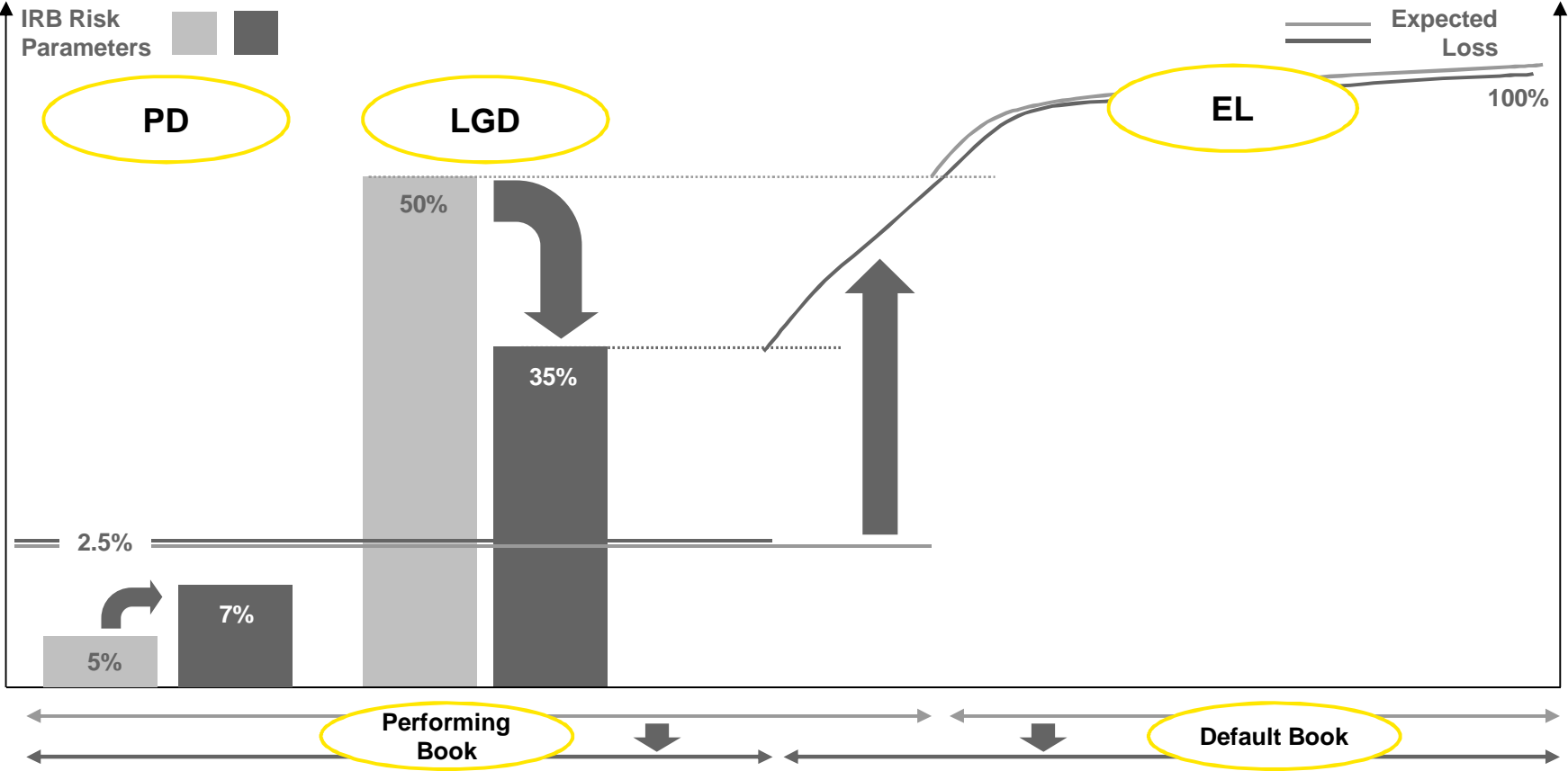
The IRB Approach

...harmonised in the TRIM-led medium-term path...



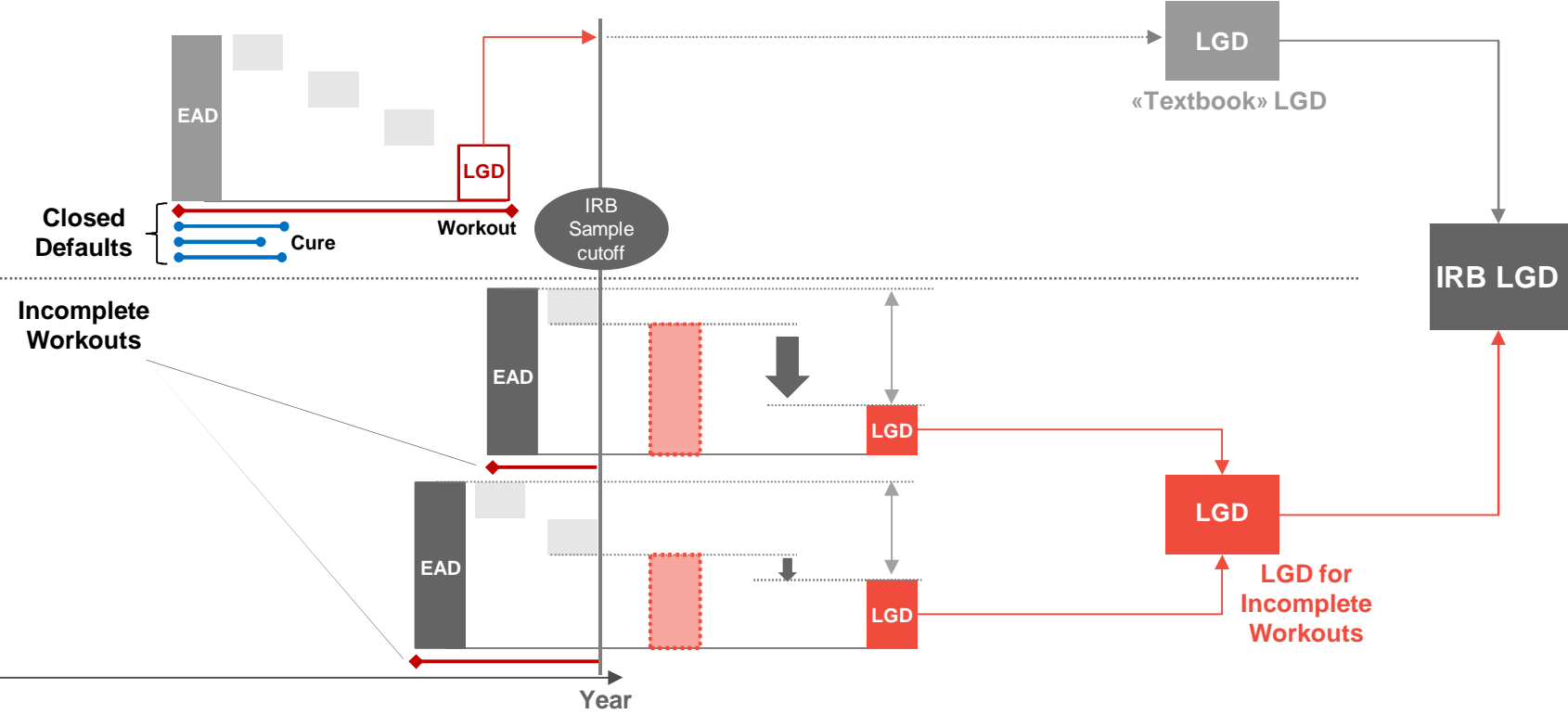
The IRB Approach ...by the definition of Default...

The review of the Definition of Default has a two-fold impact on Book and parameters. An estimation of the overall impact is underway at the EBA with the QIS in scope of final Guidelines.



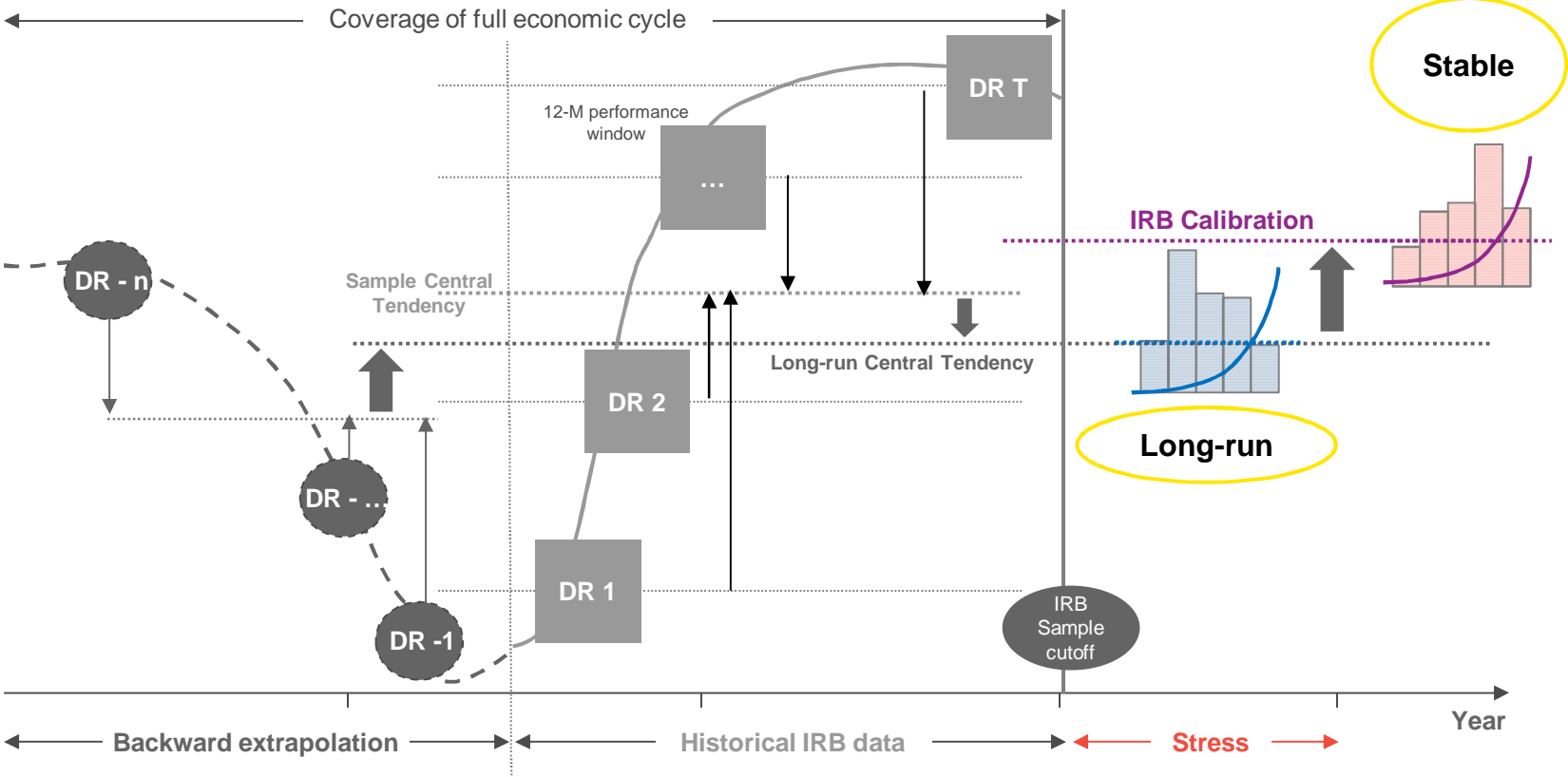
The IRB Approach ...LGD Quantification...

LGD Quantification will be required to be consistent with PD quantification in terms of calibration sample. Incomplete Workouts are prescribed to be discounted, conservatively considering future net recoveries.



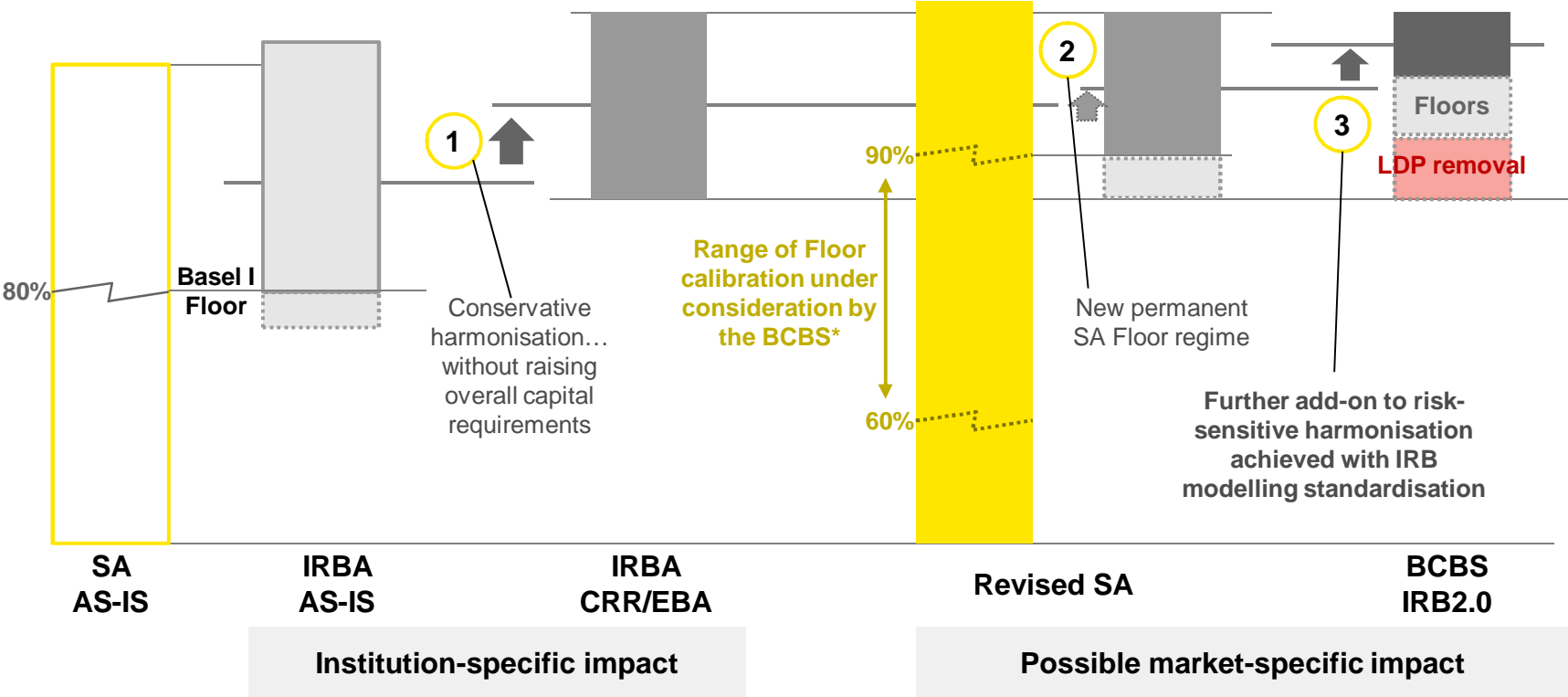
The IRB Approach ...and PD Quantification...

The calibration of PD models requires a long-run calibration covering a full economic cycle, including stress effects. Further guidance is to be released by the EBA and BCBS on calibration technicalities (e.g. grade-level vs. portfolio-level).



The IRB and Standardised Approaches ...as a bridge to Basel IV.

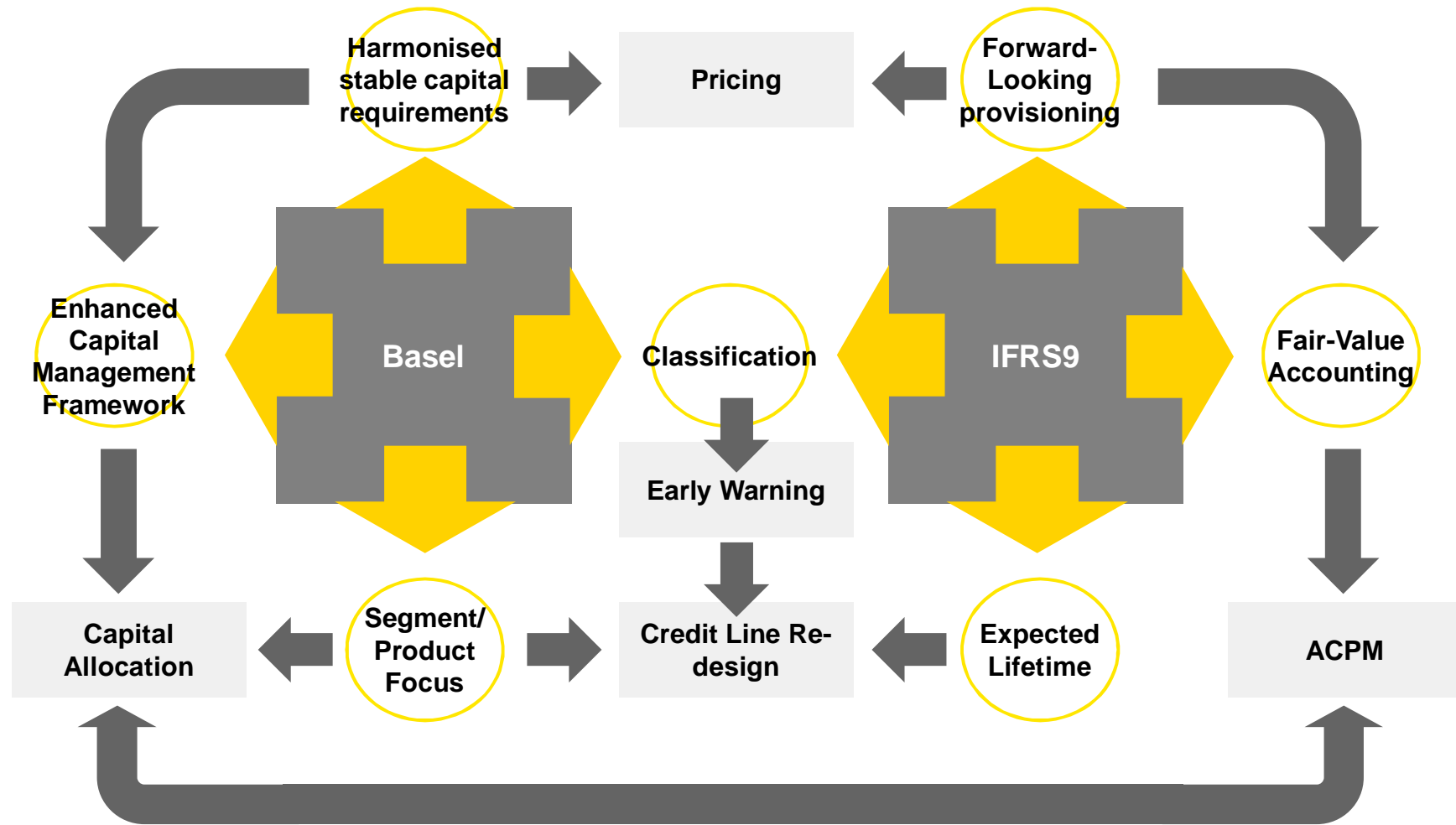
Adjustments to CRR-consistent EBA guidelines/thinking is in line with IRB modelling fine-tuning advocated in the BCBS revision to the IRB Approach. The scale of final IRB Requirements will be impacted by final SA-based floors and finalisation of extra-modelling BCBS IRB Approach design.



* BCBS "Reducing variation in credit risk-weighted assets – constraints on the use of internal model approaches", March 2016.

Regulatory framework

Forward-looking credit risk management themes



Thank You

Annex



The IRB Approach

An upcoming path of conservative harmonisation...

The EBA 2013 study on the comparability of the risk estimates and capital requirements revealed significant discrepancies in risk estimates and capital requirements that do not stem from differences in the underlying risk profiles:

- ▶ **The IRB framework has proven its validity** as a risk sensitive method of measuring capital requirements, and it also encourages institutions to implement sound and sophisticated internal risk management practices;
- ▶ However, the very high degree of flexibility permitted under the approach has compromised **comparability in capital requirements**.



The IRB Approach ...regulated by short-term Regulation enhancements...

The EBA Technical Standards and Guidelines on the IRB Approach scheduled for release until mid-2017 are aimed at **harmonising key drivers of RWA inhomogeneity** as far as allowed by the CRR.

Harmonised application within the CRR requirements		
Outstanding RTS Consultation	RTS on IRB Assessment Methodology	Future of the IRB Approach CRR scope
<ul style="list-style-type: none"> ▶ IRB roll-out and Permanent Partial Use ▶ Definition of Default*: <ul style="list-style-type: none"> ▶ Past-Due Materiality threshold ▶ Implementation of the Default definition 	<ul style="list-style-type: none"> ▶ Standard for the competent authorities in the assessment of compliance of minimum IRB requirements within CRR legislation. ▶ The ECB will review all supervised banks' internal credit models. ▶ Benchmarking 	<ul style="list-style-type: none"> ▶ The EBA plans to further harmonise risk estimates with the release of additional RTSs and Guidelines. ▶ The planned regulatory developments will impact: <ul style="list-style-type: none"> ▶ Definition of default ▶ PD and LGD calibration ▶ "In Default" LGD and ELBE ▶ Treatment of defaulted assets ▶ Scope of use of the IRB Approach

* Due in July 2016, see EBA Press Newsletter, June 2016.

The IRB Approach ...and medium-term convergence to Basel IV IRB.

Further key parts of the EBA agenda for **improving comparability and reliability of internal models** can be addressed in the **medium term**, with a **CRR review**, to be **in case** undertaken in line with the **finalisation of the BCBS proposals on the evolution of the IRB and Standardised approaches**.

CRR Review for Credit Risk

Future of the IRB Approach CRR updates

- ▶ A more **fundamental review of the IRB approach** is also being considered, requiring a legislative change of the CRR
- ▶ The main issues to be addressed:
 - ▶ **LDP portfolios**
 - ▶ **PPU**
 - ▶ **Philosophy of rating models**
 - ▶ **LGD calibration**
- ▶ **Internal approaches for Low-Default Portfolios deemed not more reliable than ECAI Ratings/Market valuations**
- ▶ **Remove the option to use the IRB approaches** for certain (**LDP**) exposures;
- ▶ Where the **IRB approaches** remain available:
 - ▶ adopt **IRB-parameter floors**
 - ▶ further specification of **parameter estimation practices**

BCBS constraints on the use of internal model approaches

BCBS gradual and holistic review of Sovereign framework

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