



EBA/RTS/2014/14

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# EBA FINAL draft Regulatory Technical Standards

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specifying conditions according to which competent authorities may permit institutions to use relevant data covering shorter time period (data waiver permission)

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# 1. Executive Summary

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The Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD)<sup>1</sup> set out prudential requirements for banks and other financial institutions which have been applied from 1 January 2014. Among others, the CRR contains specific mandates for the EBA to develop draft Regulatory Technical Standards (RTS) to specify the conditions according to which competent authorities (CAs) may grant permission to institutions to use relevant data covering a period of two years rather than five years for estimation of risk parameters, when they implement the Internal Rating Based Approach (IRB Approach).

## **Main features of the draft RTS**

In accordance with the CRR/CRD IV, institutions may request, when implementing the IRB Approach, permission from CAs to use data covering a period of two rather than five years for probability of default (PD), own-loss given default (LGD) and own-conversion factor (CF) estimates for certain type of exposures. This waiver may encourage the migration of some institutions to the IRB Approach, which is considered more risk-sensitive than the Standardised Approach. Institutions are required to collect extended historical data after implementation of the IRB Approach.

The EBA recognises the increased uncertainty of the estimation of risk parameters that result from the use of a shorter data history. Therefore, to limit the potential implications for the calculation of own funds requirements, the EBA has introduced limiting conditions for the use of the data waiver, namely by excluding low-default portfolios as well as restricting the application of the data waiver to a limited proportion of assets.

To further mitigate the risks associated with using shorter data series, the requirements also highlight the importance of applying an appropriate margin of conservatism to parameter estimates as well as ensuring that there is an enhanced data vetting process. Moreover, institutions should prove that relevant data covering a longer period is not available.

Furthermore, it has been concluded that after five years of IRB implementation by institutions, sufficient data history should already be available. Therefore, permission for data waiver should not be allowed after five years have elapsed from the first permission granted to an institution.

Finally, these RTS ensure the application of the principles of proportionality and legal clarity. Therefore, the EBA has concluded that the provisions of these RTS should apply only to new data waiver permissions to be granted by the competent authorities.

## **Next steps**

The EBA must submit the draft RTS to the Commission by 31 December 2014.

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<sup>1</sup> Regulation (EU) No 575/2013 of 26 June 2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

## 2. Background and rationale

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The Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD)<sup>2</sup> set out prudential requirements for banks and other financial institutions which have been applied from 1 January 2014. Among others, the CRR contains specific mandates for the EBA to develop draft Regulatory Technical Standards (RTS) to specify the conditions according to which competent authorities (CAs) may grant permission to institutions to use relevant data covering a period of two years rather than five years for estimation of risk parameters, when they implement the Internal Rating Based Approach (IRB Approach).

### Background of the draft RTS

In accordance with Articles 180(1)(h), 180(2)(e), 181(2) and 182(3) of the CRR, institutions may request, when they implement the IRB Approach, permission from the CAs to use data covering a period of two rather than five years for probability of default (PD), own-loss given default (LGD) and own-conversion factor (CF) estimates. The CRR differentiates the application of the data waiver to certain types of exposures. For retail exposures, the data waiver can be applied to all risk parameters. For non-retail exposures, an institution can only use the data waiver for the PD parameter, and only in the event that the institution has not received permission to use own-LGD or own-CF estimates. Institutions are required to collect extended historical data after implementation of the IRB Approach.

The EBA recognises that the data waiver has already been in force in the European Union since 2007, in accordance with Directive 2006/48/EC. The data waiver was introduced to encourage institutions to move towards the internal models, as stated in the recitals of both the CRR and CRD. Recital 42 of the CRR states that 'Credit institutions and investment firms should be encouraged to move towards the more risk-sensitive approaches ... Notwithstanding this, the more risk-sensitive approaches require considerable expertise and resources as well as data of high quality and sufficient volume.' Recital 70 of the CRD states that 'Where credit risk is material, institutions should ... generally seek to implement internal ratings-based approaches or internal models.'

Following an impact assessment, the EBA has concluded that most of the major European institutions have already been using the IRB Approach for several years, and that potential new data waiver requests arising from new IRB applications are rather likely to be limited. Moreover, the EBA has concluded that the application of a shorter data history increases the uncertainty of the estimation of risk parameters. In order to limit the potential implications for the calculation of own funds requirements, the EBA has introduced limiting conditions for the use of the data waiver. First, low-default portfolios have been excluded from using the data waiver. Second, the total data waiver coverage is capped. This coverage is assessed on the basis of two metrics: exposure values and risk-weighted exposure amount. The quantitative thresholds are set

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<sup>2</sup> Regulation (EU) No 575/2013 of 26 June 2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.



sufficiently low for coverage so as ensure the application of the data waiver is limited to a small subset of institution assets.

To further mitigate the risks associated with using shorter data series, the requirements also emphasise the importance of applying an appropriate margin of conservatism to parameter estimates, as well as ensuring that there is an enhanced data vetting process. Moreover, institutions should prove that relevant time series data covering a longer period is not available.

Furthermore, in accordance with the CRR, a data waiver may be granted by CAs 'when they [institutions] implement the IRB Approach ...' Therefore, it has been concluded that after five years of IRB implementation by an institution, sufficient data history should already be available to that institution. Therefore, permission for data waiver should not be allowed after five years have elapsed from the first permission granted to an institution.

Finally, it is necessary to ensure that the conditions laid down in these RTS do not produce unintended consequences that could be unduly detrimental to institutions. The purpose of these RTS is to ensure the application of the principles of proportionality and legal clarity; therefore, the provisions of these RTS should apply only to new data waiver permissions to be granted by the competent authorities. Whilst important, this provision will only have limited application: it will clearly be limited in time and will only be relevant for institutions that have been authorised to use the data waiver in the last three years before implementation of the draft RTS by the European Commission.

### 3. EBA FINAL draft Regulatory Technical Standards specifying conditions according to which competent authorities may permit institutions to use relevant data covering shorter time period (data waiver permission)

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EUROPEAN COMMISSION

Brussels, **XXX**  
[...](2012) **XXX** draft

**COMMISSION DELEGATED REGULATION (EU) No .../..**

**of **XXX****

[...]

(Text with EEA relevance)

**COMMISSION DELEGATED REGULATION (EU) No .../..**

of **XXX**

[...]

**supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 with regard to regulatory technical standards specifying conditions according to which competent authorities may permit institutions to use relevant data covering shorter time period (data waiver permission)**

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to 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<sup>3</sup>, and in particular Articles 180(3), 181(3) and 182(4) thereof,

Whereas:

- (1) Institutions and any parent undertaking and its subsidiaries may, in accordance with Articles 180(1)(h) and 2(e), 181(2) and 182(3) of Regulation (EU) No 575/2013, request, when they implement the IRB Approach, for permission from the competent authorities to use data covering a period of two rather than five years for PD, own-LGD and own-conversion factor estimates for certain type of exposures. The period to be covered should increase by one year each year until relevant data cover a period of five years. Accordingly, there is a need to specify the conditions according to which the competent authorities may grant these permissions.
- (2) Competent authorities should verify that institutions comply with the requirements laid down in the Regulation before they grant the data waiver permission; institutions ceasing to comply with the requirements of this Regulation should have recourse to Article 146 of Regulation (EU) No 575/2013.
- (3) It is recognised that estimating risk parameters becomes more difficult the shorter the data history. Therefore and with a view to ensure that the waiver is limited to a small subset of institution assets, there is a need for setting a maximum quantitative threshold, both at the level of the exposure value and at the level of the IRB- and Standardized-Approach calculated risk-weighted exposures amount for which the permission for the data waiver can be granted. For the same purpose, portfolios

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<sup>3</sup> OJ L 176, 27.06.2013, p. 1.



where composition of types of exposures firmly characterised by few or no defaults observed are explicitly excluded from the scope of application of the permission for data waiver.

- (4) To ensure prudent calculation of own funds requirements, other considerations should also be taken into account by competent authorities when assessing requests for data waiver permissions. Specifically, institutions requesting permission for the use of shorter data series should apply an appropriate margin of conservatism. Moreover, institutions should prove to the satisfaction of the competent authorities the lack of accurate, complete or appropriate longer time series of data. Given that the impact on own funds requirements may be higher as a consequence of inaccurate data, institutions should also employ additional data quality validation procedures commensurate with the smaller sample size.
- (5) Types of exposures which are not included in the institution's portfolio at the time when the institution first implements the IRB Approach, should not be considered eligible for the granting of a data waiver permission. Conversely, data waiver permissions should be granted only for types of exposures that are included in the institution's portfolio at the time when the institution first implements the IRB Approach, whether these exposures move to the IRB Approach immediately or subsequently in accordance with the sequential roll-out plan.
- (6) The purpose of the data waiver is to provide an exemption from the obligation to use five years' historic data for the estimation of IRB parameters for types of exposures that exist in the institution's portfolio, when the institution first implements the IRB Approach. After five years from that first implementation, institutions should have collected sufficient data to no longer require use of the waiver. Therefore, data waiver permissions should not be granted after five years have elapsed from the first implementation of the IRB Approach.
- (7) There is a need to ensure that conditions laid down in this Regulation are proportionate and do not produce unintended consequences, which could be unduly detrimental for institutions. Mindful that retrospective applicability of this Regulation should be avoided and with a view to enhance legal certainty, it is explicitly provided that the provisions of the Regulation should apply only to new data waiver permissions to be granted by the competent authorities.
- (8) The regulatory technical standards required by Articles 180(3)(a), 181(3)(b) and 182(4)(b) of Regulation (EU) No 575/2013 all relate to the conditions under which a data waiver may be granted. To ensure coherence and for the purpose of simplicity, this Regulation addresses the regulatory technical standard requirements of all three Articles.
- (9) The level of application of this Regulation is determined in accordance with Title II of Part I of Regulation (EU) No 575/2013 at the level of the individual institution, be it a stand-alone institution or a parent or a subsidiary.
- (10) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the European Commission.
- (11) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking



Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010<sup>4</sup> of the European Parliament and of the Council.

HAS ADOPTED THIS REGULATION:

### *Article 1*

#### *Subject matter*

This Regulation lays down the conditions under which competent authorities may grant to institutions permissions to use data covering a period of two rather than five years for PD, own-LGD and own-conversion factor estimates, in accordance with Articles 180(1)(h), 180(2)(e), 181(2) or 182(3) of Regulation (EU) 575/2013.

### *Article 2*

#### *Definitions*

1. “data waiver permission” means any permission granted by a competent authority to an institution to use data covering a period of two rather than five years for PD, own-LGD and own-conversion factor estimates, in accordance with Articles 180(1)(h), 180(2)(e), 181(2) or 182(3) of Regulation (EU) 575/2013.
2. “data waiver permission in force” means a permission granted and not revoked or expired.
3. “total exposure value” means the aggregate exposure value of all types of exposures measured for credit and dilution risk, before reduction of specific credit risk adjustments, additional value adjustments in accordance with Articles 34 and 110 of Regulation (EU) 575/2013 and of other own funds reductions.
4. “total risk-weighted exposure amount” means the aggregate risk exposure amount of all types of exposures, risk-weighted for credit and dilution risk in accordance with the approach applied by the institution.

### *Article 3*

#### *General provision*

Competent authorities may grant data waiver permissions provided that all conditions referred to in Articles 4 to 7 are met.

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<sup>4</sup> OJ L 331, 15.12.2010, p. 12 as amended by Regulation (EU) 1022/2013 of the European Parliament and of the Council, OJ 287, 29.10.2013, p. 5.

## *Article 4*

### *Conditions for eligibility of exposures*

1. Subject to the limitations of paragraphs 2 to 4, all types of exposures shall be eligible for data waiver permissions.
2. Exposures to central governments, central banks and institutions, as these classes are referred to in points (a) and (b) of Article 147(2) of Regulation (EU) 575/2013 shall not be eligible.
3. Exposures to corporates referred to in point (c) of the above Article 147(2) shall be eligible, provided that the specific type of exposures are not structurally characterised by few or no observed defaults.
4. Types of exposures, which did not exist at the time when the institution first implements the IRB Approach shall not be eligible for a data waiver permission.

## *Article 5*

### *Quantitative conditions*

Competent authorities may grant the data waiver permission, provided that the institution does not exceed both thresholds referred to in (a) and (b) taking also into account the exposure for which the permission is requested:

- (a) The total exposure value of all data waiver permissions in force shall not exceed 5% of the institution's total exposure value.
- (b) The total risk-weighted exposure amount of all data waiver permissions in force shall not exceed 5% of the institution's total risk-weighted exposure amount.

## *Article 6*

### *Qualitative conditions*

The institution shall provide evidence that all the following conditions are met for every type of exposure:

- (a) Longer time series data are unavailable or unsuitable due to lack of accuracy, completeness or appropriateness.
- (b) An appropriate margin of conservatism is applied, in accordance with Article 179(1)(a) of Regulation (EU) 575/2013 to adequately compensate for the expected range of estimation errors arising from the use of shorter historic data series.
- (c) The data input vetting process referred to in Article 174(b) of Regulation (EU) 575/2013 is enhanced for these shorter time series.



*Article 7*

*Timing conditions*

No data waiver permission shall be granted after five years have elapsed from the time when the institution is first granted a permission in accordance with Article 143 of Regulation (EU) 575/2013 to implement the IRB Approach.

*Article 8*

*Transitional provision*

The provisions of this Regulation shall apply to data waiver permissions to be granted after its entry into force.

*Article 9*

*Entry into force*

This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission  
The President*

*[For the Commission  
On behalf of the President*

*[Position]*

## 4. Accompanying documents

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### 4.1 Cost- Benefit Analysis / Impact Assessment

#### **Problem definition**

The provisions regarding the minimum historical observation period used for the estimation of probability of default (PD), loss given default (LGD) and conversion factor (CF) have been included in Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR) as a continuation of the requirements laid down in Annex IV, Part 4, paragraphs 66, 71, 82 and 86 of Directive 2006/48/EC (Capital Requirements Directive – CRD).

In accordance with Articles 180(1)(h), 180(2)(e), 181(2) and 182(3) CRR, the institutions, instead of using an historical observation period (data sample) of at least five years, subject to the permission of competent authorities (CAs), may use for the estimation of probability of default (PD), own-loss given default (LGD) and own-conversion factor (CF) estimates, when they implement the IRB Approach, relevant data covering a period of two years. The period to be covered shall increase by one year each year until relevant data cover a period of five years. The data waiver can be applied to retail exposures for all risk parameters. For non-retail exposures, an institution can apply the data waiver to the PD parameter in the event that the institution has not received the permission to use own-LGD or own-CF estimates (implementation of the Foundation IRB Approach).

Following the aforementioned provisions, the EBA shall develop draft RTS to specify the conditions according to which a CA may permit an institution to use relevant data covering a period of two years.

The present impact assessment (IA) will examine several options in specifying the conditions to be used in the legal text of the RTS.

#### **Objectives**

The data waiver has been introduced to encourage institutions to move towards more risk-sensitive approaches (IRB Approach for credit risk), as stated in the recitals of both the CRR and Directive EU 2013/36 (Capital Requirements Directive IV – CRD IV). Recital 42 of the CRR states that ‘Credit institutions and investment firms should be encouraged to move towards the more risk-sensitive approaches ... Notwithstanding this, the more risk-sensitive approaches require considerable expertise and resources as well as data of high quality and sufficient volume.’ Recital 70 of the CRD IV states that ‘Where credit risk is material, institutions should ... generally seek to implement internal ratings-based approaches or internal models.’

Apart from the overall regulatory objective of enhanced financial stability and the implementation of risk-sensitive methods in the calculation of capital requirements which arises from the provisions of the CRR, the current RTS aim to fulfil the operational objective of setting criteria for



a data waiver permission so as to ensure that the use of shorter data series does not lead to the systematic underestimation of own funds requirements.

To do so without disrupting the functioning of existing IRB models that are the subject of a permission for data waiver, the RTS will base their provisions on what is currently applied by CAs and credit institutions and, consequently, consider what the future needs for implementing new IRB models will be.

To this end, the CAs were requested to provide answers to the questionnaire intended to describe the current status and anticipate future developments, with a view to developing the most efficient and effective regulation. Responses from 20 CAs were received on 31 October 2013, including AT, CZ, DE, DK, ES, FR, GR, HR, HU, IE, IT, LT, LU, LV, NL, PL, PT, SE, SK and the UK.

### Current status

The CAs of the EU were requested to provide the number of institutions which apply the Standardised Approach (SA) and the IRB Approach, respectively, to assess the potential candidates that would apply for the IRB Approach. Likewise, this impact assessment would:

- based on the current status, develop provisions which will not disrupt the functionality of IRB models already in place, which require a permission for data waiver; and
- at the same time, develop the necessary provisions for the future implementation of new IRB models having accounted for the expected future transitions from the SA to the IRB Approach. The expected number of transitions focused only on the internationally active credit institutions that currently follow the SA (for the reason described below).

The only potential negative impact on financial stability would arise from an improper future implementation of IRB models by the systemically important institutions that are currently applying the SA, namely from an implementation that would underestimate the risks due to the shorter data period. Given a lack of a uniform definition of systemically important institutions across the EU, the EBA used the list of globally systemically important banks (G-SIBs) published in November 2013 by the Financial Stability Board (FSB). G-SIBs are defined by the FSB as those which 'are required to meet higher supervisory expectations for risk management functions, data aggregation capabilities, risk governance and internal controls.'

Thus, the impact assessment examines the number of G-SIBs with regard to parent institutions that currently follow the SA, as a proxy for the systemically important institutions in each jurisdiction. These institutions are considered as candidates for the transition from the SA to the IRB Approach at some point in the future.

The survey results among the CAs revealed that all parent institutions listed as G-SIBs have already moved to the IRB Approach; therefore, the RTS on data waiver will not have any impact with regard to these institutions. Some G-SIB subsidiaries may still be subject to data waiver implementation but the impact on financial stability is considered non-material.

On the other hand, the non-internationally active credit institutions that follow the SA were excluded from the questionnaire as they were considered a minor source of disruptions in the financial stability of the banking sector.

It was also important to understand whether the data waiver is likely to be used in the future, given the fact that the CRD has already been in force in the EU since 2007 and that a number, if not most of the candidate IRB institutions, have already been using the IRB Approach for several years. As a proxy for the potential use of permissions for data waiver, the EBA has examined new IRB applications that resulted in permissions for data waiver between 1 January 2011 and 31 October 2013.

As shown in Table 1 below, there are two institutions, under the remit of the CAs that responded to the impact assessment questionnaire, which have been granted a data waiver. As inferred by the responses, currently, there is no low-default-probability portfolio under this waiver as, inter alia, the CAs do not allow for such exemptions on such portfolios where observations are scarce. On the other hand, retail portfolios do fall under the provision for data waiver.

**Table 1: Use of data waiver by IRB banks**

<b>Institution</b>	<b>With applicable data waiver</b>
Number 1	<i>1 bank – model for retail, from 2013</i>
Number 2	<i>1 bank – 4 models (three from 2011, one from 2013)</i>
<i>Total</i>	<i>2 banks – 5 models</i>

### **Options considered (list and analysis of options) / preferred option**

Below are the options considered before drafting the legal provisions in the text of the RTS. The second set of options were conditional on the first set of options, i.e. only once the decision on the preferred option from Set 1 was taken could the second set of options be examined. The third and fourth sets of options were considered independently.

#### **Set 1 of options (eligible portfolios)**

- (a) do not allow any portfolios to fall under the data waiver;
- (b) allow all portfolios to fall under the provision of the data waiver; or
- (c) exclude certain portfolios with idiosyncratic characteristics.

The first option has been excluded as there are still a limited number of institutions where application of data waiver could encourage implementation of the IRB Approach. The data waiver provision may be used by such institutions which, despite having the infrastructure (IRB models) in place, do not have at their disposal long time series, or the use of the entire set of time series is unsuitable due to the lack of accuracy, completeness or appropriateness.

Regarding the second option, it seems that the unlimited acceptance of shorter data series may result in a larger uncertainty of the risk parameter estimation and in a higher volatility of the own funds requirements.

Thus, the third option is considered as the preferred option as it constitutes the right balance that solves the aforementioned problems. The application of data waiver for low-default portfolios is restricted, which has an implication for the PD parameter in the event that an institution applies for the Foundation IRB Approach. Nevertheless, the institution should use the appropriate margin of conservatism when conducting estimation under the data waiver framework.

***Set 2 of options (quantitative threshold – materiality of portfolios under data waiver)***

- (a) ‘do nothing’ – do not establish any quantitative threshold for portfolios under data waiver;
- (b) establish materiality thresholds for portfolios under data waiver – set the exact quantitative threshold.

After having decided on the eligibility of the portfolios to receive permission for data waiver provisions, the establishment of a quantitative threshold should be decided. The option of establishing a quantitative threshold is favoured against the ‘do-nothing option’, as the former would limit the impact from a potential misuse of the data waiver provision for material portfolios.

**Table 2: Maximum coverage for the exempted portfolios**

<b>Institution</b>	<b>Exposure amounts</b>	<b>RWA amounts</b>
Number 1	45%	NA
Number 2	70%	80%
All other EU countries that reported data	0	0

According to the data received from the CAs, the vast majority of IRB institutions have not been using data waiver provisions, since 2011, for their portfolios / sub-portfolios under their IRB models. However, two institutions (Table 2) are currently using data waiver provisions for a material part of their credit-risk portfolios. These two cases are considered outliers among the population of institutions that apply IRB Approaches. Thus, it is proposed that not only a quantitative threshold be set, but also that it be set sufficiently low to prohibit the inclusion of large parts of portfolios under data waiver provisions and, therefore, the potential for systematic misvaluation of their risks.

***Set 3 of options (timing of data waiver implementation)***

- (a) allow permission for data waiver at the time the institution firstly implements the IRB Approach and in accordance with an approved sequential roll-out plan;
- (b) allow permission for data waiver at the time the institution implements the IRB Approach and in accordance with an approved sequential roll-out plan that spans up to a maximum of five years after first implementation.

The EBA has considered the point in time when the data waiver could be applied. In accordance with the CRR, the data waiver may be granted by CAs *'when they [institutions] implement the IRB Approach...'* Therefore, the types of exposures that are not moved to the IRB Approach at the time of the first implementation of this approach and have not been included in the first sequential roll-out plan of the institution are not eligible for permission for data waiver. This means that the data waiver is applicable to the types of exposure that exist in the institution's portfolio at the time of first implementation of the IRB Approach (either for subsequent implementation or in accordance with a sequential roll-out plan). Given the fact that the implementation of a data waiver provides an exemption from using five years' historic data, the EBA has concluded that after five years from IRB first implementation, institutions should have already collected data covering a sufficient period of time. This implies that the implementation of data waiver should not be allowed after five years have elapsed from the first permission granted to an institution.

#### ***Set 4 of options (proportionality)***

- (a) 'do nothing' – i.e. to revoke existing IRB permissions for data waiver applications where the requirements of these RTS are not fulfilled;
- (b) introduce a proportionality clause.

The EBA has concluded that it is necessary to ensure that the conditions laid down in these RTS do not produce unintended consequences that could be unduly detrimental for institutions; this is particularly the case when the former SA calculation systems are not valid or available any longer. The purpose of these RTS is to ensure the application of the principles of proportionality and legal clarity; thus, the provisions of these RTS should apply only to new data waiver permissions to be granted by the competent authorities. The impact of this provision would be low: it would be clearly limited in time and would only be relevant for institutions which have been authorised to use the data waiver in the last three years before implementation of the draft RTS by the European Commission.

#### **Cost-benefit analysis**

For the sake of proportionality in conducting the current impact assessment, the cost-benefit analysis (CBA) (i) refers only to the combination of preferred options selected from Set 1, Set 2, Set 3 and Set 4 (Set 1, (c) / Set 2, (b) / Set 3, (b) / Set 4, (b)) and not to every possible combination of the examined options; and (ii) has been conducted at a high level.

The current section examines the cost and benefits for institutions and CAs arising from the implementation of the aforementioned combined set of preferred options.

The tables below only examine the case of underestimating the risks, considered to be the most harmful for financial stability.

The CBA aims to:

- identify the sources of cost and benefits from underestimating (Scenario A) the risks after allowing the data waiver and conducting a high-level CBA to assess the magnitude of such costs and benefits; and
- identify the sources of cost and benefits from overestimating (Scenario B) the risks after allowing the data waiver and conducting a high-level CBA to assess the magnitude of such costs and benefits.

Since the magnitude of costs and benefits was difficult to measure, the estimation was conducted on the 'best-effort basis'. Nevertheless, it is expected that the quantitative thresholds will limit any negative impact and would allow the draft RTS to facilitate the use of IRB models.

Tables 3 and 4 show the main sources of costs and benefits from misestimating the risks after permitting data waiver provisions.

**Table 3: Scenario A / underestimation of risks due to the application of data waiver provisions**

	Description of costs	Description of benefits
Institutions	Harming financial stability due to underestimation of risk	Lower capital requirements due to underestimation of risk
CAs	Costs arising from reputational risk due to lack of accuracy of own funds requirements	

**Table 4: Scenario B / overestimation of risks due to the application of data waiver provisions**

	Description of costs	Description of benefits
Institutions	Higher capital requirements due to overestimation of risk	Enhanced, although unneeded, financial stability due to additional own funds requirements
CAs	Reputational risk due to lack of accuracy of own funds requirements	Benefits arising from positive reputation due to the use the appropriate margin of conservatism

Tables 3 and 4 show the estimated magnitude of costs and benefits from misestimating the risks under data waiver provisions. The costs from a potential underestimation of risks would have a negative effect on financial stability, of low to negligible magnitude, which could consequently require the relevant authorities to inject new capital into the banking sector. This impact is assessed to be 'low to negligible', as well as the additional capital that should be injected because the institutions are not considered systemically important, namely G-SIBs. On the other hand, the CAs would receive negative publicity from the underestimation of risks which could harm their reputation. In the worst case scenario, the overall net impact from a potential underestimation would be low.

**Table 5: Magnitude of costs / benefits according to scenario A**

	Costs	Benefits	Net impact
Institutions	<u>Low</u> for internationally active / <u>Negligible to zero</u> for non-internationally active	<u>Negligible to zero</u>	<u>Low to negligible (positive)</u>

	<b>Costs</b>	<b>Benefits</b>	<b>Net impact</b>
	(average: <u>low to negligible</u> )		
CAs	<u>Negligible</u>		
Total	<u>Low to negligible</u>	<u>Negligible to zero</u>	<u>Low to negligible (positive)</u>

The overestimation of risk would create enhanced financial stability in the banking sector which would be of marginal effect due to the low materiality of the portfolios under the data waiver provisions. Regarding the CAs, the reputational benefits from overestimating the risks are estimated to be zero, as the CAs rarely receive positive comments for their conservatism (in this case due to the use the appropriate margin of conservatism). Thus, it is expected that the overestimation would not have any effect on the CAs.

**Table 6: Magnitude of costs / benefits according to scenario B**

	<b>Costs</b>	<b>Benefits</b>	<b>Net impact</b>
Institutions	Negligible to zero	Negligible to zero	Zero
CAs		Zero	Zero
Total	Negligible to zero	Negligible to zero	Zero

The results of the present impact assessment are to be used as the basis for drafting the legal text for data waiver provisions.



## 4.2 Views of the Banking Stakeholder Group (BSG)

This section sets out the BSG comments on draft Regulatory Technical Standards (RTS), specifying conditions according to which competent authorities may permit institutions to use relevant data covering shorter time period (data waiver permission) (EBA/CP/2014/02).

### General comments

Overall, it is considered that limiting the possibility for data waiver permission to types of exposures existing at the first permission, as well as five years from the time of the first permission, could prove disadvantageous to institutions which are not full-service at the time of the first permission. Relevant data of appropriate length is not necessarily available for institutions which introduce new product types after the first permission has been given, in particular for the LGD- and CF-parameters for retail exposures. Moreover, it is considered that experience test requirements given by Article 145(3) of the CRR would provide adequate limitations on the eligibility of the data waiver program on types of exposures which are not covered during the first permission or the sequential roll-out plan. Therefore, it is proposed that the data waiver permissions should also be eligible for new types of exposures (and new legal entities) as well as beyond the five-year period after the first permission.

Clarification is requested with regard to the application of quantitative conditions on an individual or consolidated level, or whether it is simultaneously applicable to both. It has been also suggested that application of the same quantitative conditions on an individual and consolidated basis may cause situations where the legal structure of an institution makes certain types of exposures non-eligible.

Finally, it has been suggested that the RTS may have unintended consequences, i.e. the combination of both the timing and exposure conditions of the data waiver may encourage institutions to use time-series which might be unsuitable for particular types of exposures. Therefore, putting more weight on the quantitative conditions, rather than the timing and types of exposures, would have the benefit of making it easier for institutions to extend the use of the IRB Approach.

### 4.3 Feedback on the public consultation and on the opinion of the BSG

The EBA publicly consulted on the draft proposal contained in this paper.

The consultation period lasted for three months and ended on 7 June 2014. A total of six responses were received, all of them were published on the EBA website.

This paper presents a summary of the key points and other comments arising from the consultation, the analysis and discussion triggered by these comments and the actions taken to address them if deemed necessary.

In many cases several industry bodies made similar comments or the same body repeated its comments in the response to different questions. In such cases, the comments, and EBA analysis are included in the section of this paper where EBA considers them most appropriate.

Changes to the draft RTS have been incorporated as a result of the responses received during the public consultation.

#### **Summary of key issues and the EBA's response**

The main points raised by the industry and by the BSG about the draft RTS are as follows:

(1) Two respondents raised general concerns that these RTS limit the eligibility for data waiver permission substantially. One of these respondents said that these RTS are not in line with the intention of the CRR which is to encourage timely adoption of the IRB Approach.

(2) Five respondents were concerned about limiting the eligible exposures for data waiver permission to those available at the time of the first application, namely types of exposures that move to the IRB Approach in the first phase as well as types of exposures that will subsequently move on to the IRB Approach following the sequential implementation plan during the maximum period of five years after the granting of first approval to institutions. These respondents argued that institutions might be rolling out IRB on portfolios temporarily exempt from the IRB Approach, or on newly acquired portfolios, or for new business. Hence data waiver was vital to encourage timely adoption of the IRB Approach.

(3) Two respondents commented on the application of quantitative thresholds. One respondent was concerned that 5% thresholds were extremely low and proposed raising them to 25%, mainly because data waiver was supposed to facilitate institutions' access to the IRB Approach and in the current framework, institutions were allowed to use the data waiver for the whole portfolio. In addition, one respondent did not support the proposal that exposures with low defaults were not eligible for data waiver permission.



(4) Finally, some respondents asked for clarification of the following: a) definition of institution; b) total risk-weighted exposure amount for applicable approach; c) definition of low default portfolio; d) appropriate margin of conservatism; and e) exactly when conditions laid down in these RTS should be applied.

These and the other issues are addressed in detail in the ‘Summary of responses to the consultation and the EBA’s analysis’ below but there follows a response to the specific points mentioned above:

(1) Data waiver was initially permitted in the EU legal framework to promote the use of internal models. Following an impact assessment, the EBA concluded that most major European financial institutions had already been using the IRB Approach for several years, and that there were likely to be only a few new data waiver requests arising from new IRB applications. The need for the data waiver seems less important. The EBA also concluded that using a shorter data history increases the uncertainty of risk parameter estimates. To limit the potential implications on the calculation of own funds requirements, the EBA has introduced limiting conditions for the use of the data waiver. The EBA believes that there are still a few institutions where applying data waiver might encourage implementation of the IRB Approach for small subsets of assets.

(2) The CRR provides that a data waiver may be granted by CAs ‘*when [institutions] implement the IRB Approach*’. This means that the data waiver is applicable to the types of exposures that exist in the institution’s portfolio at the time of first implementation of the IRB Approach either for subsequent implementation or in accordance with a sequential roll-out plan. Therefore, newly acquired portfolios or new businesses are not eligible for data waiver permission. Consequently, where the portfolio exists when first permission is granted, after five years, a minimum data series should be available and data waiver is not necessary. Moreover, Article 145 of the CRR requires at least three years’ experience of using the rating systems for institutions’ internal purposes, including for newly acquired portfolios. Since these portfolios usually contain some data, the data waiver limitation is less important in practice.

(3) The quantitative thresholds are set sufficiently low in terms of coverage so as to prohibit the data waiver being applied to a large subset of institutions’ exposures and thus creating the potential for systematic misvaluation of their risks. In addition to this and specifically given judgmental considerations (calibration technics and margin of conservatism) the EBA decided to exclude the low default portfolio exposures from data waiver application.

(4) Finally, in order to enhance implementation of these RTS, the EBA introduced clarification in the recital 3 that calculation of total risk-weighted exposure amounts should be based on the IRB and Standardised Approach. Furthermore, recital 2 makes clear that institutions should fulfil all relevant conditions as stipulated therein before and after they grant the waiver permission. Moreover, additional details on definition of low default portfolios are specified in recital 3. For other points, these RTS are sufficiently clear and further clarification is not necessary.

## Summary of responses to the consultation and the EBA's analysis

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
General comments	Two respondents raised a general concern that these RTS limit of the eligibility for data waiver permission substantially. One of these respondents said that these RTS were not in line with intention of the CRR which is to encourage timely adoption of the IRB Approach. Another said that these RTS might encourage institutions to use time-series that might be unsuitable for particular types of exposures.	Data waiver was initially permitted in the EU legal framework to promote the use of internal models; after several years of using the IRB Approach, there seems less need for such waivers. New IRB applications from 2011 to October 2013 also show that only two institutions applied for data waivers. The EBA expects the RTS to restrict the use of the data waiver. Nonetheless, there are still a few institutions where applying the data waiver might encourage implementation of the IRB Approach for small subsets of assets.	No change.
Definition of institution	Three respondents asked for clarification about the entity involved in the data waiver permission. They suggested introducing an institution definition in Article 2 of the draft RTS. Some respondents proposed limiting this definition to parent company. One respondent commented that application of the same quantitative conditions on an individual and consolidated basis might cause situations where the legal structure of an institution makes certain types of exposures non-eligible.	Recital 9 of draft RTS makes clear that the level of application is in accordance with Title II of Part I of the CRR at the level of the individual institution being a stand-alone institution or a parent institution or a subsidiary. Repetition of the CRR definition in the RTS is not permitted.	No change.
Definition of 'total risk-weighted exposure amount' (Article 2(4))	One respondent asks for clarification about whether the sum of the risk-weighted exposure amounts under the Standardised Approach and IRB Approach for credit and dilution risk should be used for calculation of the total risk-weighted exposure amount.	Total risk-weighted exposure amount is defined as 'the aggregate risk exposure amount of all types of exposures, risk-weighted for credit and dilution risk in accordance with the approach applied by the institution'. Hence risk-weighted exposure amounts under the Standardised Approach and IRB Approach for credit and dilution risk should be used. Further	Changes to recital 3 of draft RTS

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
<p>Conditions for eligibility of exposures – low default portfolios (Article 4(2) and 4(3))</p>	<p>One respondent does not support the proposal that types of exposures with low defaults are not eligible for data waiver permission. This is given by the fact that the CRR gives possibility for CAs to grant the data waiver permission for exposure classes to central governments, central banks and institutions. Further these draft RTS require additional margin of conservatism and the CRR invites institutions to use judgmental considerations if data are scarce.</p> <p>The same respondent asks for clarification on Article 4(3) of these draft RTS with regard to further specification of portfolios structurally characterised by few or no observed defaults.</p>	<p>clarification is made in recital 3.</p> <p>Shortening the length of time series for low default portfolios combined with judgmental considerations (calibration technics and margin of conservatism) increases the uncertainty of risk parameter estimates and the volatility of own funds requirements. The EBA believes that data waivers should not be used for these portfolios.</p> <p>The institutions develop their models for types of exposures which are defined in accordance with Article 142(1)(2) of the CRR as ‘a group of homogeneously managed exposures ...’ Given the flexibility for institutions to define the types of exposures and complexity of this issue the EBA decided to provide additional details in recital 3 and not to introduce a strict definition of low default portfolios at the moment. The EBA has however taken note of the proposal and will consider it in future work.</p>	<p>Changes to recital 3 of draft RTS</p>
<p>Conditions for eligibility of exposures and timing conditions (Article 4(4))</p>	<p>Five respondents expressed their concern about limiting the eligible exposures for data waiver permission to those existing at the time of the first application, namely exposures that move to the IRB Approach in the first phase as well as exposures that will subsequently move on to the IRB Approach in accordance with sequential implementation plan. They argue that data waiver permission for newly acquired portfolios is vital to encourage timely adoption of the IRB Approach.</p>	<p>In accordance with Article 180(1)(h) and (2)(e), Article 181(2) and Article 182(3) of the CRR, a data waiver may be granted by CAs ‘when [institutions] implement the IRB Approach’. This means that the data waiver is applicable to the types of exposures that exist in the institution’s portfolio at the time of first implementation of the IRB Approach either for direct implementation or in accordance with a sequential roll-out plan.</p> <p>Article 145 of the CRR requires there to be at least</p>	<p>No change.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		<p>three years' experience of using the rating systems for newly acquired portfolios for institutions' internal purposes. The rating systems have to be used in the internal risk measurement and management processes and adequate documentation of the effective operation of the rating systems should be available. In addition, since newly acquired portfolios usually contain some data, the data waiver limitation is less important in practice.</p>	
Quantitative conditions	<p>Two respondents commented on the application of quantitative thresholds. One respondent expressed concern that 5% thresholds were extremely low and proposed raising the thresholds to 25%, mainly because data waiver was supposed to facilitate institutions' access to the IRB Approach and in the current framework, institutions were allowed to use the data waiver for the whole portfolio. The 5% threshold was too strict and was not consistent with the CRR's purpose. The application of higher thresholds was justified by qualitative requirements introduced in the draft RTS. Another respondent commented that quantitative thresholds might hamper institutions' efforts to move towards internal models and should therefore be set carefully.</p> <p>One respondent asked whether the quantitative conditions applied only to data waiver permissions requested in addition, which would lead to threshold breaches (if granted), or whether the draft RTS also stipulated repeals of data waiver permissions granted under the draft RTS if thresholds were breached, for</p>	<p>The quantitative thresholds are set sufficiently low in terms of coverage so as to prohibit the data waiver being applied to a large subset of institutions' exposures and thus creating the potential for systematic misevaluation of their risks.</p> <p>Institutions should fulfil all relevant conditions stipulated in the RTS before and after they grant the waiver permission. The quantitative conditions should apply to all data waivers currently being used and to those requested in addition. Institutions</p>	<p>No changes.</p> <p>New recital 2 is introduced.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	example, as a result of portfolio growth.	ceasing to comply with the requirements of the draft RTS should have recourse to Article 146 of the CRR. The EBA has introduced a new recital to clarify this matter further.	
Qualitative conditions – margin of conservatism (Article 6(b))	One respondent asks for more specific definition of the term ‘appropriate margin of conservatism’. Another respondent asks for distinction between those portfolios where there is a lack of data, and those portfolios where older data is deemed less relevant.	The term ‘margin of conservatism’ is introduced in Article 179(1)(a) of the CRR, and is applicable to relevant minimum IRB requirements. It means that this term is not specifically limited to the data waiver application and that CAs must assess appropriateness of the level of margin of conservatism. It is expected that the level of margin of conservatism will depend on the length of the data series; why the data are not taken into consideration (whether due to lack of data or lack of accuracy) are less important. The EBA intends to clarify further the appropriateness of the margin of conservatism for the purpose of relevant minimum IRB requirements in dedicated guidelines.	No change.
Timing (Article 7)	conditions In addition to the comments on limiting the eligible types of exposures for data waiver permission to those available at the time of the first application, five respondents raised concerns about additional limits on the five-year period after the granting of first approval to institutions. They argued that institutions may be rolling out the IRB Approach on portfolios temporarily exempted from the IRB Approach, or on newly acquired portfolios, or for new business. Hence data waiver was vital so that these portfolios could be included in institutions’ rating systems in good time. Furthermore, they suggested that the changing nature of institutions’ internal organisation,	In accordance with Article 180(1)(h) and (2)(e), Article 181(2) and Article 182(3) of the CRR, a data waiver may be granted by CAs ‘when [institutions] implement the IRB Approach’. This means that the data waiver is applicable to the types of exposures that exist in the institution’s portfolio at the time of first implementation of the IRB Approach either for direct implementation or in accordance with a sequential roll-out plan. Therefore, the newly acquired portfolios or new businesses are not eligible for data waiver permission. Where the portfolio exists when first permission is	No change.

<b>Comments</b>	<b>Summary of responses received</b>	<b>EBA analysis</b>	<b>Amendments to the proposals</b>
	<p>strategy and IT systems, adaptation to market developments and potential data collection difficulties (e.g. changes in definition of default) meant that any specific time constraints should be avoided.</p>	<p>granted, after five years, a minimum data series should be available and data waiver is not necessary. With regard to the different reasons which may lead to changes in underlying data, the EBA believes that relevant margin of conservatism should be applied to existing data, e.g. for changes in definition of default.</p>	