

EBA/CP/2014/02

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Consultation Paper

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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1. Responding to this Consultation

The EBA invites comments on all proposals put forward in this paper.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 7 June 2014. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) N° 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive Summary

The Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD)¹ 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 initial 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 nothing should be perceived as having the effect to repeal data waiver permissions already in force.

Next steps

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

¹ 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.

3. Background and rationale

The Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD)² 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

² 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 to prohibit the application of the data waiver to a material 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 initial 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, these RTS explicitly provide that nothing should be perceived as having the effect of repealing data waiver permissions already in force. 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.

4. 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)



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 648/2012³, 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.
- (2) It is recognised that estimating risk parameters becomes more difficult the shorter the data history. Therefore, the Regulation introduces, on the basis of a materiality principle, a quantitative threshold for the exposures value and risk-weighted exposures amounts for credit and dilution risk for which the permission for the data waiver can be granted. For the same purpose, portfolios with few or no defaults observed are explicitly excluded from the scope of application of the permission for data waiver.
- (3) 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. They should also employ an enhanced vetting process of the data input for these shorter time series.

³ OJ L 176, 27.06.2013, p. 1.

- (4) The data waiver may be permitted only for exposures that exist in the institution's portfolio at the time of initial implementation of the IRB approach; institutions may seek permission for the use of the data waiver for exposures that will move to IRB approach at first use, as well as for exposures that will subsequently move on to IRB approach in accordance with sequential roll-out plan.
- (5) The purpose of the data waiver is to provide an exemption from using five years' worth of historic data for estimation of IRB parameters. After five years from IRB initial implementation institutions should have collected sufficient data to no longer require use of the waiver. Therefore, the data waiver implementation is not allowed after five years have elapsed from the initial permission granted to an institution.
- (6) 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 nothing in this Regulation should be perceived as having the effect to repeal data waiver permissions already in force.
- (7) 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.
- (8) 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.
- (9) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the European Commission.
- (10) 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 1093/2010⁴ of the European Parliament and of the Council.

HAS ADOPTED THIS REGULATION:

⁴ 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 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 of the European Parliament and of the Council 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.

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 of the European Parliament and of the Council 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. Exposures, which did not exist at the time of the initial permission to use 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 of the European Parliament and of the Council to adequately compensate for any uncertainty 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 of the European Parliament and of the Council 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 of the initial permission granted to an institution in accordance with Article 143 of Regulation (EU) 575/2013 of the European Parliament and of the Council.

Article 8

Data waiver permissions in force

Nothing in this Regulation should be perceived as having the effect of repealing data waiver permissions already in 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]

5. Accompanying documents

5.1 Draft 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

Institution	<i>With applicable data waiver</i>
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

Institution	Exposure amounts	RWA amounts
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 material parts of portfolios under data waiver provisions and, therefore, the potential for systematic misevaluation of their risks.

Set 3 of options (timing of data waiver implementation)

- (a) allow permission for data waiver at the time the institution initially 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 initial 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 initial implementation of this approach and have not been included in the initial 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 initial 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' worth of historic data, the EBA has concluded that after five years from IRB initial 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 initial 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, these RTS explicitly provide that nothing should be perceived as having the effect to repeal data waiver permissions already in force. 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 (average: <u>low to negligible</u>)	<u>Negligible to zero</u>	<u>Low to negligible (positive)</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

	Costs	Benefits	Net impact
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.