AFME response – EBA consultation on RTS for assessing the materiality of extensions and changes of the IRBA

March 10, 2025

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to respond to the EBA’s **consultation on draft RTS for assessing the materiality of extensions and changes of the IRBA.**

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

**Overarching Comments**

The Original CRR (529/2014) – which entered into force over 10 years ago – forms the basis upon which banks structure their supervisory dialogue whenever they plan to change features of their IRB framework. We note from banks’ experience, the level of involvement for both banks and supervisors highly depend on the categorization of the model change. For instance, for banks supervised by SSM, whenever a material change is triggered, it systematically leads to an IMI mission with strong investment and corresponding phases and planning. The whole process can last several years until supervisory approval is given, without which banks cannot implement the changes. The duration of such a process for material changes may be deterrent for timely implementation of changes, which aim to improve the IRB framework for banks. In this context, although there are some welcome simplifications introduced in the EBA consultation paper, not all the new features will significantly alleviate the burden for both banks and supervisors as numerous “material changes” will still be required.

Hence, from a broader perspective, we would welcome any initiative to further simplify the framework. In particular, we think in case of material classification, there should be a judgmental layer at the end of the process which allows changes to the classification from a material to non-material categorization. This judgmental reclassification could be an option available to both parties (banks and supervisors), which can be justified based on the impact for the bank and could be proposed by the bank in the first instance. Experience shows that in some cases, supervisors are bound by Regulation 529/2014 to apply material change even if their judgement would have concluded to it to be a non-material change. We think that such leeway to a judgmental reclassification should be explicitly considered in the RTS.

In addition, we note the EBA, in collaboration with competent authorities has explored the option of combining qualitative and quantitative criteria to trigger a material model change. While EBA’s preliminary conclusion at this stage is that qualitative triggers should be maintained on a standalone basis, we find the suggestion to combine overall very relevant.

We wish to emphasise our general preference for this approach, which in our view may be further enhanced by incorporating the general idea of flexibility granted to competent authorities for the requalification of the model changes, as follows:

* If both qualitative and quantitative criteria for material change are met, the change should be considered material, unless the competent authority makes use of the above-mentioned judgmental reclassification.
* If only one of the two criteria is met, an ex-ante notification shall be made by the supervised institution, allowing the JST/CA to analyse the information provided, request additional information if necessary, and ultimately determine whether the qualification of the model change should be elevated to ‘material’, under a risk-based, prudent but proportionate approach.

These supervisory discretions would prevent an overly mechanistic approach to materiality classification - which may generate unintended burden for supervisors and institutions, thereby supporting the objective of simplification pursued in the update of CDR 529/2014, as indicated in the recital (5) of the draft RTS subject to consultation.

**Question 1. Do you have any comments on the clarification of the scope of the revised draft regulatory technical standards to specify the conditions for assessing the materiality of the use of an existing rating system for other additional exposures not already covered by that rating system and changes to rating systems under the IRB Approach?**

AFME members welcome the introduction of a recital to try and clarify the scope of the RTS, however there are several uncertainties remaining around what should or should not be considered in scope and additional aspects the EBA should take into account and confirm in the RTS. We have listed these below.

Scope:

* The EBA is requested to clarify what it understands "updates to the data used in the ongoing application of the rating systems in order to calculate the risk weight exposure amount for the application portfolio" to include and provide examples. Given that one type of data update remains within the scope of the RTS and the other out of scope, a clearer definition would be very helpful. In particular, we consider that the remediation of data quality issues (e.g. amending missing/incorrect LTV input data or fixing data traceability issues) should be out of scope, even if they affect the modelling process (as it should not be considered an IRB change).
* We think it should be made clear that the recalibration after backtesting only as a mechanical effect of adding one additional year of default is considered out of scope to avoid undue burden for both banks and supervisors. Our recommendation is that they are part of the “ongoing application of rating systems” which should be clarified. Alternatively it can be subject to ex post notification.
* Changes in exposure class: There is a lack of clarity on the boundaries of the changes to be notified regarding those having an impact on RWA formula: indeed, we could have changes that impact the RWA formula but without impacting the PD, LGD, CCF models. For example, the allocation to the exposure class Retail-QRRE, which under the new CRR3 represents an explicit new exposure class as per amended Art 147 depends on a list of criteria (including the check on the volatility of loss rate) but it does not necessarily impact the models of the underlying credit risk parameters. We would like the EBA to confirm if this type of change requires notification since par. 11 – page 7 (“On the contrary, the methodology for assigning exposures to exposure classes continues to fall within the scope of the RTS on model change as changes to this methodology may also affect the internal risk estimates used for RWEA calculation and not only the formula used for RWEA calculation itself.”) could be open to interpretation. This clarification is also needed with respect to par. 22. It is our understanding that just assigning exposures to exposures classes should not be in scope of this RTS and would welcome clarity on this in the final RTS.

With regard to the changes to rating systems, it is mentioned that changes not affecting the performance of a rating system are not in scope of the RTS, regardless of whether they are mandatory or not and even if they have a potential impact on the RWA calculation. However, in the case of changes to the methodology for assigning exposures to exposures classes, they are always considered in scope of the RTS due to the potential impact on the risk parameters. Nevertheless, not all the changes to the exposure classes definition may affect the internal risk estimates, as the range of application of rating systems may not vary. The range of applications of each rating system is defined based on management practices and business mode, so the range is consistent over time, according to paragraph 13 of the EBA/GL/2017/16, although it could imply a potential misalignment with the exposure classes defined for RWA calculation. This interpretation is also sustained in the Basel Framework, standard CRE 30.5:

‘*The classification of exposures in this way is broadly consistent with established bank practice. However, some banks may use different definitions in their internal risk management and measurement systems. While it is not the intention of the Committee to require banks to change the way in which they manage their business and risks, banks are required to apply the appropriate treatment to each exposure for the purposes of deriving their minimum capital requirement. Banks must demonstrate to supervisors that their methodology for assigning exposures to different classes is appropriate and consistent over time’.*

* Model performance: we understand that the EBA is capitalizing on its statement made on CRR3, which segments classifications based on whether the changes impact the model performance. In this context, we understand that the need for model change submission is based on whether the changes impact the performance of the models or not.
* Further, apart from the validation process, it is our understanding that the rest of the rating automation processes that have no impact on the model performance do not fall within the scope irrespective of the quantitative impact on capital. In this context, the RTS should state permanently that changes imposed by regulation which do not affect the performance of the rating systems are out of scope.
* The EBA should clarify whether changes in FIRB LGD and CCF are considered in scope (where they do not directly affect aspects within scope of a rating system). In par. 11 of section 3.2 the EBA states that changes in the parameters Maturity (M), Total Annual Sales (S) and the SA-CCF assignment to off-balance sheet items which solely affect the formula used for RWEA calculation should not be within the scope of the RTS on model change as they do not directly affect aspects within the scope of a rating system. With this differentiation of changes which solely affect the formula used for RWEA calculation we would like clarity on whether changes in the assignment of F-IRB LGD to exposure would be also considered as part of these items, in the same way that SA-CCF assignment to off-balance sheet items are considered.
* Can the EBA confirm if the following examples should be considered out of the scope of these RTS:
* Population of amortization tables of the loans to apply the M of 162.2(a)
* Identification of trade finance products and apply the M of 162.3.
* Identification of covered bonds to apply the LGD of 11.25%.
* Classification or reclassification of products/portfolios in buckets of the Article 111(2) and Annex 1 to assign SA CCFs when an institution has not received permission to use AIRB-CCF (Art.166.8, 166.8 bis and 166.8 ter).
* Identification of new products that could fall under the CCF of the 166.8.b to apply SA CCFs.
* Identification of revenues in the application of the SME factor.
* Starting to apply an option that is directly stated in the CRR (e.g. Article 161.7 states that an institution shall be permitted to apply article 230 even for funded credit protection that cannot be included in an A-IRB LGD (because of the lack of data).
* Identify new products that could fall under the CCF of the 166.8 or 166.10. (FIRB CCF).
* Changes in the application of the SME factor.
* Application of the FIRB approach to the corporate and institutions exposure classes (e.g. Application of CRMT, Application of new real guarantees to apply LGD 230 (FIRB), Recognition of additional credit protection in the regulatory LGD under FIRB).
* Implementation of the regulatory floors (e.g. related to PD and LGD parameters, related to the 1-day floor.
* Actions to be conducted to implement regulatory add-ons as per Final Decision letters from the Supervisor.
* Actions to be conducted to implement the remediation actions committed with Supervisor which are duly and timely notified in accordance with the remediation plans.
* Alignment between parameters used for internal business purposes and those used for regulatory capital purposes regarding CRR Art. 179(1) and Par. 208-210 of the EAB GLs on PD and LGD estimation.
* Changes in the internal methodological guidelines and standards.
* Consideration of the year as 365.25 days in the calculation of the maturity of the total assets of the customer.
* The adaptation of institutions’ internal policies on IRB changes and management to implement these RTS should be out of scope.
* Finally, we are of the view that the alignment of the documentation or implementation of the ECB approved model (pre-notification or material change) resulting from the outcome of the proper functioning of the control environment should also be excluded from scope of these RTS. Corrections of errors in the technical implementation of the model, which are not due to a recalibration of the model, should be out of scope. For instance, allocation excels.

**Additional clarification:**

* **Reflecting Machine learning in the context of the RTS and impact on model changes**

A general point of clarification is related to changes/model novelties related to Machine Learning components possibly nested into internal models’ structures to enhance their performance. Such technicalities tend to be characterized by high frequency of reparameterizations that appears not fitting under both the current and new RTS. In this vein, it is necessary to get full clarity on how to cope with these technicalities and this revision of the RTS is an opportunity to qualify the regulatory requirements on this topic, duly considering the related peculiarities. Should the Recital (2) be left unchanged, such recital could deter the use of such techniques. **Thus, we propose to alleviate the burden by considering that a mechanical recalibration following regular updates of data, without any rebuilding of the model, should be subject to an annual ex-post notification.**

**Question 2. Do you have any comments on the clarifications and revisions made to the qualitative criteria for assessing the materiality of changes as described in the Annex I, part II, Section 1 and Annex I, part II, Section 2?**

It is very important to ensure consistency in the implementation of this RTS, given has such a broad scope which could leave too much room for interpretation between supervisors and jurisdictions.

In the new RTS, changes in the methodology used for assigning exposures to different exposure classes (according to article 147 of CRR) are reclassified as ex-ante notifications. However, the EBA mandate according to article 143(5) of CRR is to write “standards to specify the conditions for assessing the materiality of the use of an existing rating system for other additional exposures not already covered by that rating system and changes to rating systems under the IRB Approach”. The EBA therefore presumes that rating systems and exposure classes are interlinked, meaning that any change to exposure classes will impact rating systems. However, such a link is not always the case in practice. Thus, we think such changes should be excluded from the scope of the RTS when such changes do not affect the models. Such changes will be consistent with the EBA stance which is to exclude aspects outside the rating systems which may only affect the RWA formula.

As mentioned in the criteria 2(f) from Annex I, Part II, Section 1 of the new proposed regulation, change in the fundamental methodology for estimating PD/LGD now includes methodology for deriving appropriate adjustments and should be considered as a material change (ex-ante notifications otherwise). For these cases, it is within the remit of the bank to define what constitutes a “change in the fundamental methodology”. In this exercise, difficulties may appear as from a supervisory perspective, this fundamental feature could not solely be based on RWA impact. Depending on the size of the exposures/models for the bank, the limit between material change and non-material change is objectively captured through RWA impact, rather than through more subjective criteria determined by the bank. This is why the limits between material and non-material regarding methodologies for estimating PD/LGD should be based on other quantitative criteria (RWA outcomes), these metrics being defined by the bank. This should be clarified in the regulation.

In general, while we acknowledge that focusing on final grades can be a valid alternative, we are deeply concerned that excluding other statistically sound options imposes undue burdens on modelling efforts. In practical terms, demonstrating such tests would necessitate the development of a shadow estimation of the risk parameter. We therefore recommend retaining this as an open option rather than prescribing that option as the sole valid alternative.

We have the following specific comments on the clarifications on qualitative criteria and the requirement to have an appropriate framework to assess the significance of i) changes in the rank ordering; ii) changes in the distribution of obligors, facilities and exposures across grade or pool, and the need to measure the metrics on the basis of final ratings or risk parameters:

* 1. given the requirement of having a MoC at grade level (as per ECB EGIM) a change in the MoC could have an effect on rank ordering or distribution despite no change in the main structure of the model. As such the analysis should be done on the final parameter both before and after MoC. The same holds for the presence of a limitation operating at the level of single parameter PD-LGD-CCF and for which a model change is expected to address the related obligation. Indeed, while we understand its consideration in the quantitative RWA criteria for the qualitative assessment, the interference of a limitation in the assessment of the change and in the analysis of rank ordering and distribution should be avoided (being in the end a pure additional supervisory conservative measure).
  2. Even if the analysis were defined on the final parameter it has to be ensured by the bank that the definition of the framework differentiates between changes impacting the risk differentiation (expected as more intrusive in the structure of the model) and changes in the risk quantification (e.g. resulting for example from a pure extension of the time series). Indeed, the inclusion of additional years in a pure recalibration (rather than a basic review of a MoC) could trigger disorder in the rank ordering and rating distribution (since the parameter could increase or decrease) but without generating changes in the rating criteria / the risk differentiation features of the model (this is also clearly highlighted in Annex I - Part II - Section 1, letters d) and letters f). It appears clear that the check on rank ordering and rating distribution results is particularly relevant for changes in the rating criteria as referred to in Article 170(1)(c) and (e) and Article 170(4) (i.e. letter d)) rather in presence of changes for estimating PDs, LGDs including best estimate of expected loss, and conversion factors according to Articles 180, 181 and 182, thus pertaining to the risk quantification (i.e. letter f)). Therefore, and stated in any case the check on RWA quantitative impact, banks need to have a framework that allows for an appropriate differentiation in the nature of the change (i.e. if related to risk differentiation or to risk quantification) when it comes to assessing the outcomes of the rank ordering and grade/pools distribution changes.
  3. Finally the rank ordering assessment for the Slotting Approach, which is a purely regulatory based approach with just 4 possible performing grades, appears as excessive considering that Specialized Lending portfolios are characterized by a limited number of observations by definition and, as such, by an inherent volatility not necessarily due to the model change per se but to the features of the portfolio snapshot considered in the specific point-in-time of the assessment.

In addition, we believe room for flexibility should be introduced in the sentence “*For example, changes to traffic light thresholds of test metrics leading to a more positive validation result are deemed a material change; however, where such changes lead to an equally strict or more conservative validation result, an ex-ante notification is deemed appropriate. For this purpose, institutions should carefully consider the impact of the change on aggregated test outcomes where thresholds are set at a level higher than an individual test metric.*” Our understanding is that simple changes to traffic light thresholds of test metrics which lead to a more positive validation result are deemed a material change. On the other hand, there could be changes in the aggregation workflow of a test executed at different levels, that should be simulated to get the direction and the classification of the change. Since the validation framework could apply to an extended number of models across a banking group, the full simulation exercise would be very burdensome; for this reason, we deem that the institution should have the possibility to sample the models to simulate, using appropriate materiality criteria, and classify the change based on the outcome on the sample. Moreover, some little fluctuations may be possible, e.g. most of the final test outcomes are the same except for a couple, which are less severe; in this case, we deem a classification as material would be incorrect. Further, there are cases in which the institution should have the possibility for a qualitative classification assessment, to complement the “mechanical” outcome of the simulation. For instance, if the institution introduces/reviews a materiality concept in the aggregation workflow, which penalizes less the immaterial component; per se, such an intervention is more lenient, but the final simulated outcome on the sampled models could be very marginal.

On the definition of default, we consider the following cases should be specified to be out of the scope of this RTS:

1. Changes due to obligations or recommendations by IMIs or OSIs that do not result in a change to the IMI model being handled instead by the remediation plan agreed with the supervisor.
2. Changes due to changes in the rules that do not result in a change in the model. That means, any change imposed by new regulatory requirements should not be considered as material.
3. Changes in the marking criteria (e.g. thresholds, calculation formulas, etc.) of UTPs

We would appreciate more clarity on what “method to identify if the obligor is more than 90 dpd” is to be considered.

**Changes to definition of default:**

Regarding changes to the definition of default, we welcome the EBA initiative to introduce better separation between changes which entail a material change and the other changes where ex-ante notifications are needed. In the proposed RTS, the following cases are listed as material:

* *they change the method to identify if the obligor is more than 90 days past due on any material credit obligation*
* *they change the level of application of the definition of default for retail exposures*
* *they change the use of external data*
* *they change whether an indication of unlikeliness to pay results in an automatic or in a manual default reclassification*
* *they change the default classification in the reference dataset or scope of application of a rating system in a significant manner, the measure and level of which will have been defined by the institution*

Dealing with the newly introduced criteria, we would like to share several comments:

* We understand from the public hearing that the EBA would include in the “material” category an extensive range of changes to definition of default related mostly to operational implementation issues. We note that not only may these changes have no impact on rating systems, but such changes do not prevent the well-functioning of risk management functions. For instance, in a change of the batch frequency for defaulting exposures from monthly to daily (with exact date and number of days being stored in any case), the impact is only on the frequency at which the new defaults are stored in the systems. Such change not only is an improvement of the framework but also does not modify the result of the identification of default and nor impact the rating systems.
* In addition, some new requirements remain vague regarding “changes whether an indication of Unlikeliness to Pay results in an automatic or in a manual default reclassification”. Although it appears clear from the EBA position that modifying an UTP default event trigger from automatic to manual reclassification generate a material change, we understand that changes from manual to automatic reclassification rather than changes in general to UTP triggers shall be notified a minima as ex-ante notifications. In practice, the UTP detection starts from the elementary early warning signals underlying the Portfolio Credit Monitoring process. The system of EWS strictly pertains to the credit operations of the banks and is subject to ongoing updates and fine-tuning thus requiring timeliness in the execution. Because of unclear boundaries of this requirement included in the new RTS, there can be a risk of introducing severe slowdown to credit operations if an ex-ante notification is foreseen also for changes introduced at the level of elementary indicators in the EWS (that may have, even if indirectly, an impact on the default detection). This point deserves further attention and clarifications when defining the boundaries of the application perimeter of the RTS: our opinion is that process changes pertaining exclusively to the credit operations at the level of the elementary indicators of the Early Warning System should not be in the scope of this RTS; only changes in the rules and methodologies of default detection shall be covered by the RTS.
* The classification criteria for a change in definition of default is considered as stand-alone compared to the related impact that would stem from internal models (that will be captured with other criteria of the RTS). In this regard it is interesting to note that no impact on RW for non-defaulted assets is expected from the change of the definition of default (“*It is also noted that a change of the definition of default alone does not change the risk weighting of non-defaulted exposures*”). Nonetheless, it has to be considered that the change in the default classification criteria would be prone to change the asset quality composition (i.e. performing/default composition), as such the pure migration from performing to default due to the changed classification policy is likely to generate an RWA impact due to the pure shift from one bucket to another. However, the RWA impact for changes in the definition of default are in the end purely related to the portfolio shift due to changed default criteria without any impact on the internal models (this latter being covered by other criteria of the RTS). Clarifications in this sense are of particular importance from the operational and execution standpoint considering the experience gained in the context of the material model changes carried out during the IRB Repair Program to adhere to the EBA-GL-2016-07 (where the impact on internal models were required). In this perspective, the most objective way to assess the impact would be to rely on quantitative metrics (e.g.: impacted default volumetry which could easier to assess than RWA impact). As an illustrative example, the change of an existing UTP trigger which was leading systematic to default into a trigger which is assessed on case-by-case basis (other indication of UTP) leads to an impact of only few defaults, thus having nearly no impact on risk parameters. Such example of change is not material. This is why we would introduce a distinction between changes with an impact on ratings systems and changes with no impact on rating systems. In this sense, the subparagraph (e) of the point 3 of Annex I, Part I, Section 1 could be enough to capture the materiality of the change (see our amendment below which would change (e) to letter (b)).

**Considering all of our concerns, we therefore propose the following amendment of the RTS (Annex I, Part I, Section 1):**

|  |  |
| --- | --- |
| Initial text | Proposal for amended text |
| *3. Changes in the definition of default according to Article 178 of Regulation (EU) No 575/2013, if any of the following conditions are met:*  *(a) they change the method to identify if the obligor is more than 90 days past due on any material credit obligation according to Article 178(1)(b) of Regulation (EU) No 575/2013;*  *(b) they change the level of application of the definition of default for retail exposures according to Article 178(1), second subparagraph of Regulation (EU) No 575/2013;*  *(c) they change the use of external data according to Article 178(4) of Regulation (EU) No 575/2013;*  *(d) they change whether an indication of unlikeliness to pay according to Article 178(3) of Regulation (EU) No 575/2013 results in an automatic or in a manual default reclassification;*  *(e) they change the default classification in the reference dataset or scope of application of a rating system in a significant manner, the measure and level of which will have been defined by the institution*. | *3. Changes in the methodologies and rules to the definition of default according to Article 178 of Regulation (EU) No 575/2013, if any of the following conditions are met:*  ***~~(a) they change the method to identify if the obligor is more than 90 days past due on any material credit obligation according to Article 178(1)(b) of Regulation (EU) No 575/2013~~;***  *~~(b)~~(a) they change the level of application of the definition of default for retail exposures according to Article 178(1), second subparagraph of Regulation (EU) No 575/2013;*  ***~~(c) they change the use of external data according to Article 178(4) of Regulation (EU) No 575/2013;~~***  ***~~(d) they change whether an indication of unlikeliness to pay according to Article 178(3) of Regulation (EU) No 575/2013 results in an automatic or in a manual default reclassification;~~***  *~~(e)~~(b) they change the default classification in the reference dataset or scope of application of a rating system in a significant manner, the measure and level of which will have been defined by the institution*. ***When defining their metrics, institutions can use the relative impacted volumetry of default.*** |

In addition to this amendment, Article 4 of the RTS which relates to the calculation of quantitative criteria (RWA impact) should be modified to delete the quantitative criteria when changes to the definition of default are concerned (in order to rely uniquely on the quantitative measure regarding the change in the RDS or scope of application of a rating system in significant manner).

**Question 3. Do you have any comments on the clarifications and revisions made to the qualitative criteria for assessing the materiality of extensions and reductions as described in the Annex I, Part I, Section 1 and Annex I, Part I, Section 2?**

According to paragraph 19 of the Background and rationale, the EBA mentions a *“As such, in accordance with Article 148(1) of Regulation (EU) 2024/1623, additional exposures that were not risk weighted by another rating system (i.e. under the Standardized Approach or by F-IRB if the scope of an LGD model is extended) require in any case an approval by the competent authority and are not within scope of this RTS”.* However, Article 148(1) only refers to the approval of the roll-out plan and does not concern the request for an approval of a new rating system. In addition, we consider that for this concrete case, if representativeness and comparability can also be demonstrated, it should allow for its inclusion within a pre-notification, in the interest of flexibility within the process (e.g. the extension of a rating system to a type of exposure -of small size- currently treated under the standardised approach, for which representativeness can be argued).

**Question 4. Do you have any comments on the introduced clarification on the implementation of the quantitative threshold described in Article 4(1)(c)(i) and 4(1)(d)(i)?**

We consider the proposal to aggregate changes to different rating systems and to be implemented sequentially over time as positive. Nonetheless, we deem that greater clarification is needed in the sentence “*sequentially over time*”.

* Is it limited to stepwise implementation plans of a single change or is it intended also as multiple uncorrelated changes to the same rating systems: e.g. subsequent re-calibration shall be considered as separate changes? Another example could be linked to changes due to ECB findings, which may have six months long action plans: shall we consider the changes as separate, although within 12 months? How should their impact be calculated?
* In case a change affecting different rating systems, could institutions understand that these changes can be implemented sequentially? For instance, if the subsidiary of a bank receives a finding (e.g. on mortgages model) that could impact their standards or methodologies, the adjustment to solve the subsidiary finding should be implemented in all mortgage’s models within the Group sequentially to the extent mortgages models are to be reviewed considering the Groups’ model calendar. Moreover, how should this impact be calculated?

Regarding Article 3.3, which sets out where several cases should be assessed as a single change, we would like to highlight that following considerations should be taken into account and where necessary clarified:

* Modifications of the same nature and to the same rating system implemented sequentially over time should be bundled in a single model change. In such instances, we understand that we are to notify the supervisor upfront with a plan of changes (changes that we identify so far) and we may in practice end up with a multiyear plan. In this regard, the RTS could clarify that it is possible to introduce a reasonable and limited timeframe for the changes to be bundled.
* One change affecting multiple rating systems (i.e. a single change to rating systems in the IRB Approach) is considered a single change and we understand that its leads to an aggregation of the RWA impact of the change across the rating systems affected. In such instances, the RTS should clarify that banks are expected to only report the aggregated metric (rather than a calculation at the level of one rating system). Moreover, clarification would be welcomed to specify that such bundle of model changes also apply for changes of the model perimeter impacting several rating systems.
* We also believe that changes in segmentation (especially for legal persons) should be assessed as a whole due to the inherent dependencies across different rating systems (e.g., depending on turnover, a customer could fall into Large Corporates, Enterprises, or SMEs). In our view, assessing a change in a segmented way separately as reductions and extensions will artificially inflate the materiality. Instead, we believe a more effective way to streamline the supervisory decision process would be to assess segmentation changes as a single and standalone type of change.

**Question 5. Do you have any comments on the revised 15% threshold described in Article 4(1)(d)(ii) related to the materiality of extensions of the range of application of rating systems?**

As per our general comments on the need for qualitative and quantitative thresholds with a supervisory override, we welcome this. Nonetheless, more room for flexibility should be introduced in the sentence: “*This risk of this weak model performance on the new exposures becomes more pressing the larger the extensions of range of application of the rating system is in comparison to the existing range of application*”. It is indeed possible that the RWA increases by more than 15%, but the actual performance measured in terms of ranking ability is under a significant threshold; in this case, we deem that a material classification may be excessive and that further justification on performance could be added to support the non-materiality despite the RWA increase. Indeed, the new ratio introduced by the EBA may lead to counterintuitive results. Hence, there should be flexibility for the supervisor should be able to step-in for a judgement led decision on reclassification.

Let us assume we have an extension on perimeter B of the rating system initially applied to A. We understand from the new EBA requirement that the new ratio will be calculated in the following way:

We can derive two cases in the calculation:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Example 1 | EAD | RWEA - Before | RWEA - After | New ratio |
| Perimeter A | 100 | 50 | 50 |  |
| Perimeter B | 100 | 50 | 5 | 10% |
| Perimeter A+B | 200 | 100 | 55 |  |
|  |  |  |  |  |
| Example 2 | EAD | RWEA - Before | RWEA - After | New ratio |
| Perimeter A | 100 | 50 | 50 |  |
| Perimeter B | 100 | 50 | 100 | 200% |
| Perimeter A+B | 200 | 100 | 150 |  |

In Example 1, the model extended on perimeter B will lead to an important RWA reduction on the additional exposures (division by 10 of the RWA impact with ) and the new calculation results in a 10% ratio. In Example 2, the model extended on perimeter B will double the RWA impact on the additional exposures (100 after compared to 50 before) and the new calculation will result in a 200% ratio. The new calculation will imply that the scrutiny should be on the Example 2 case. However, the high reduction of RWA is observed for the Example 1 for which the model initially applied on A will lead to reduce significantly the RWA if it is applied on perimeter B.

In addition, the new ratio will not be relevant in the case of both reduction and extension happening at the same time.

**Question 6. Do you have any comments on the documentation requirement for extensions that require prior notification?**

The new RTS specifies that a phased change should be treated as a single change for the purposes of its impacts. However, if readiness to implement is required for the entirety of the change, the change could only be requested once everything has been completed, effectively eliminating any opportunity for phasing. In cases where changes need to be phased, the implementation date required will be covered by an implementation plan and the readiness to implement should be considered according to the implementation plan submitted as part of the documentation.).Furthermore, consultation Box 6 states: “*It was considered that validation processes of institutions may be hampered if they are required to provide, for extensions that require prior notification, also the technical documentation and the assessment report of the validation function. In particular, this implies that an institution either has to wait for the periodical validation process before submitting the extension notification or perform an ad-hoc assessment by the validation function in order to submit the extension for prior notification.*” We confirm that the validation process would be hampered by the proposed request on non-material extensions:

* The periodical validation process is executed according to the rules defined on the ECB Supplementary Validation Reporting, requires the annual validation process assesses a model version in production (not proposed, under assessment by the JST) and, in the case of PD, requires to perform the tests on the model version in production at the beginning of the observation period (e.g. for the 2025 ongoing validation with observation period 31-12-23 to 31-12-24, the model version in production at 31-12-23 shall be considered). This means that the former proposal “*wait for the periodical validation process before submitting the extension notification*” is not applicable.
* An ad hoc assessment may be the only option. Nonetheless, we would like to point out that, starting from 2024, a validation assessment is also to be included for a non-material change, when it is aimed at addressing Regulatory Findings (“a Supervised Entity may not consider that a remediation action has been fulfilled for a Regulatory Finding unless the Internal Validation Function or Internal Audit Function has confirmed that fulfilment”). For the same reasoning above on the impossibility to leverage on the periodical validation process, this request is a further additional ad-hoc activity that will hamper the validation process.

We also understand that the fact of requiring a report for perimeter extensions classified as non-material at the time those changes are approved will create a burdensome obligation that is beyond the expectations of the EBA handbook, that in paragraph 96.c clearly states that “for non-material changes to a rating system the review of the changes could be performed during the regular (yearly) validation activities, and the result of the validation function’s assessment would be communicated to the CA via the usual validation report”. This paragraph 96.c provides room for synergies, avoiding duplication of efforts (like writing of two reports or launching of the same test on to different reference dates) and giving more flexibility on the executions of IV annual plans. We therefore consider this requirement disproportionate, and we are concerned about the impact it entails in terms of effort and its alignment with Internal Validation’s annual plans, which are already under significant strain.

For this reason, it’s worth identifying a set of tests to meet the EBA expectation on the topic, e.g. the validation deliverable in case of non-material extensions could cope with representativeness, rank ordering, stability (in case leveraging on and verifying what executed by Modelling for classification purposes).

Regarding documentation listed in Article 8(1) of this RTS, the assessment report is understood as a review of the model change classification (representativeness) is not a full review report of the model of the independent review team. Moreover, we also understand from the EBA that in this context “model performance” is not understood as an anticipated backtesting exercise, therefore it is not required from institutions to submit results of a first backtesting exercise when filing for extensions (first backtesting exercise is made after implementation of the models). We think that such stance will be better understood by supervisors if it is clearly mentioned in the RTS.

**Contact:**

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