

Single Rulebook Q&A

Question ID	2021_5761
Status	Final Q&A
Legal act	Regulation (EU) No 575/2013 (CRR)
Topic	Model validation
Article	171
Paragraph	2
Subparagraph	-
COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations	Not applicable
Article/Paragraph	Not applicable
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Disclose name of institution / entity	No
Type of submitter	Individual
Subject matter	Assignment to grades or pools
Question	Do the requirements in Article 171(2) CRR refer to the Estimation of Risk Parameters or to the Application of Risk Parameters?
Background on the question	In Article 171(2) CRR, which is labelled “Assignment to grades or pools”, each sentence contains a requirement, and we do not deem it clear if it refers to the estimation process - especially model development - or to the application process. In particular it is not clear whether the last sentence of paragraph 171(2), i.e. the requirement that “The less information an institution has, the more conservative shall be its assignments of exposures to obligor and facility grades or pools.” exclusively refers to the Application of Risk Parameters.
Final answer	The requirements in Article 171(2) of Regulation (EU) No 575/2013 (CRR) refer to the assignment of obligors and facilities to grades and pools. This assignment is the result of the risk differentiation and is necessary for the application of risk parameters as well as for the estimation of risk parameters. The use of Article 171(2) CRR has been clarified in the EBA/GL/2017/16 (GL on PD and LGD estimation), as further explained in the feedback table (page 129). In particular:

	<ul style="list-style-type: none"> • Section 8.1 clarifies the conservatism that should be applied to the outcomes of the rating assignment in the context of the application of risk parameters, • However, paragraph 74 of the GL on PD and LGD estimation requires that, when assigning the obligors or exposures to grades or pools for the purpose of the one-year default rate calculation, institutions should not reflect in this assignment any ex post conservative adjustments introduced in accordance with section 8.1. <p>Therefore, it is the EBA’s understanding that the third sentence of paragraph 2 of Article 171 CRR, i.e. the requirement that “The less information an institution has, the more conservative shall be its assignments of exposures to obligor and facility grades or pools” exclusively refers to the assignment of obligors and facilities to grades and pools in the context of the application of risk parameters but not to the assignment of obligors and facilities to grades or pools in the context of the estimation of risk parameters. The reasons for this are that the conservatism in the estimation of risk is already covered by the requirements in Articles 179(1)(f) CRR (Margin of Conservatism) and that a conservative rating grade assignment could lead to a biased default rate calculation and risk parameter estimation.</p>
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