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Article	325bp
Paragraph	5 and 6
Subparagraph	5(d) and 6(c)
COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations	Not applicable
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Disclose name of institution / entity	No
Type of submitter	Competent authority
Subject matter	Estimation of default probability and loss given default under the internal default risk model for a trading book position, where those estimates are not available at trade date under an approved IRB approach
Question	Should an institution that has been granted permission to estimate own default probabilities or own default probabilities and losses given default in accordance with Section 1 of Chapter 3 of Title II of the CRR, be required to use such methodology for calculating default probability or loss given default under the internal default risk model for a trading book position, where the default probability or loss given default estimates are not available at trade date under such methodology for the corresponding obligor or facility?
Background on the question	Article 325bp(5)(d) of the CRR requires that an institution that has been granted permission to estimate default probabilities in accordance with Section 1 of Chapter 3 of Title II of the CRR uses the methodology set out in that Section (IRB approach) to calculate default probabilities in the internal default risk model. Similarly, Article 325bp(6)(c) of the CRR requires that an institution that has been granted permission to estimate losses given default in accordance with Section 1 of Chapter 3 of Title II of the CRR uses the IRB approach to calculate losses given default in the internal default risk model. An institution may not be able to calculate default probabilities or losses

given default based on the IRB approach for a particular trading book position, even though it may have been granted permission from competent authorities to use the IRB approach in accordance with Section 1 of Chapter 3 of Title II of the CRR for an exposure class or a rating system that would be applicable to that position. E.g. this could be the case when, for the issuer of a trading book position, there is no corresponding exposure in the non-trading book, which would fall in the scope of an approved rating system. In this case, for the purpose of the internal default risk model, the institution may revert to the approaches set out in Article 325bp(5)(e) and Article 325bp(6)(d) of the CRR.

Final answer

For the purpose of calculating the probability of default (PD) estimate for a trading book position under the internal default risk model, where an institution has been granted permission to estimate PDs in accordance with the IRB approach set out in Part Three, Title II, Chapter 3, Section 1 of the CRR for the corresponding issuer and where the PD estimate of that issuer is available under the IRB approach at the calculation date, as specified in Article 325bp(5)(d), the institution must use the methodology under the IRB approach to estimate the PD.

Where the PD estimate of that issuer is not available under the IRB approach at the calculation date, the institution should use one of the following approaches:

1. the IRB approach, provided that the institution complies with the requirements set out in Part Three, Title II, Chapter 3, Section 1 of the CRR for that issuer;
2. one of the approaches set out in Article 325bp(5)(e).

Analogously, for the purpose of calculating the loss given default (LGD) estimate for a trading book position under the internal default risk model, where an institution has been granted permission to estimate LGDs in accordance with the IRB approach set out in Part Three, Title II, Chapter 3, Section 1 of the CRR for the corresponding exposures and where the LGD estimate of that position is available under the IRB approach at the calculation date, as specified in Article 325bp(6)(c), the institution must use the methodology under the IRB approach to estimate the LGD of that position.

Where the LGD estimate of that position is not available under the IRB approach at the calculation date, the institution should use one of the following approaches:

1. the IRB approach, provided that the institution complies with the requirements set out in Part Three, Title II, Chapter 3, Section 1 of the CRR for that position;
2. one of the approaches set out in Article 325bp(6)(d).

The PD and LGD estimates of a given issuer or position are considered available under the IRB approach where the institution has a non-trading book exposure on that issuer or on that position, for which at the time of calculation of the PD and LGD estimates for the purposes of the internal default risk model, the institution uses the IRB approach to calculate the capital requirements for Credit Risk.

As a reminder, any approaches used for the purpose of calculating the PD and LGD estimates for a trading book position under the internal default risk model must meet all the requirements set out in Article 325bp, where relevant. In particular, where the IRB approach is used to calculate such estimates, the requirements set out in Article 325bp supersede the requirements of the IRB approach. Therefore, some adjustments to the IRB approach may be necessary when estimating PDs and LGDs to ensure compliance of the IRB approach with the requirements set out in Article 325bp.

Disclaimer:

The answers clarify provisions already contained in the applicable legislation. They do not extend in any way the rights and obligations deriving from such legislation nor do they introduce any additional requirements for the concerned operators and competent authorities. The answers are merely intended to assist natural or legal persons, including competent authorities and Union institutions and bodies in clarifying the application or implementation of the relevant legal provisions. Only the Court of Justice of the European Union is competent to authoritatively interpret Union law. The views expressed in the internal Commission Decision cannot prejudge the position that the European Commission might take before the Union and national courts.

Link

https://www.eba.europa.eu/single-rule-book-qa/qna/view/publicId/2021_5856

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