EBA REPORT ON RELIANCE ON EXTERNAL CREDIT RATINGS

DIRECTIVE 2013/36/EU ARTICLE 161(3)

EBA/REP/2021/10

EUROPEAN
BANKING
AUTHORITY

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Abbreviations

BCBS	Basel Committee on Banking Supervision
CA	Competent Authority
CRD	Directive 2013/36/EU of the European Parliament and of the Council
CRR	Regulation (EU) No 575/2013 of the European Parliament and of the Council
ECAI	External Credit Assessment Institution
FRTB	Fundamental Review of the Trading Book
IRB	Internal Ratings Based
LSI	Less Significant Institution
RWEA	Risk Weighted Exposure Amounts
SA	Standardised Approach
SI	Significant Institution

1. Introduction

This report addresses the mandate in Article 161 (3) CRD requiring the EBA, in cooperation with ESMA and EIOPA, to:

'publish a biannual report analysing the extent to which Member States' law refers to external credit ratings for regulatory purposes and the steps taken by Member States to reduce such references. Those reports shall outline how the competent authorities meet their obligations under Article 77(1) and (3) and Article 79(b). Those reports shall also outline the degree of supervisory convergence in that regard.'

In light of the finalisation of the Basel III reforms by the BCBS, which among other things aims at reducing reliance on external ratings in the credit risk framework, it is useful to assess as well the relevance of reliance of Member States' law in this regard ahead of the implementation of Basel III reforms into the EU legislative framework. This will ensure a comprehensive overview of the reliance on ratings for regulatory purposes.

Previous work has already been conducted in this field (see 2014 report[1], 2014 Discussion Paper[2], 2016 report[3]), although only partially addressing the mandate in Article 161(3) CRD, which requires an overview of the Member States' law. In order to collect the relevant information, the EBA launched a survey among EU banking supervisors in December 2020 in the context of banking regulation, complemented by a second review in February 2021 to collect further views on Pillar II considerations. The questionnaire asked for evidence in two areas:

- Whether the national law of Member States refers to external credit ratings for regulatory purposes, and whether Member States have taken any particular action to reduce such reference.
- The actions taken to increase the use of internal approaches for calculating own funds requirements (also in connection with the trading book), on reducing sole or mechanistic reliance on external credit assessments, and on considering any other additional relevant information for assessing allocation of internal capital. These questions address the mandates under Article 77(1) and (3) and Article 79(b) CRD, which are cross-referenced in the mandate for publishing a report on the references to external credit ratings in Member States' law in Article 161 (3) CRD.

[1] Report of the JC ESA on mechanistic references to credit ratings in the ESAs' guidelines and recommendations
[2] Discussion Paper on the Use of Credit Ratings by Financial Intermediaries
[3] JC ESA report on Good Supervisory Practices for Reducing Mechanistic Reliance on Credit Ratings

The second area collected separate information on how competent authorities have encouraged institutions to develop internal credit risk assessment capacity:

- for the calculation of the own funds requirements based on the so-called IRB approach;
- for the assessment of credit risk of obligors, securities or securitisation positions and credit risk at portfolio level without relying solely or mechanistically on external credit ratings;
- for the calculation of the own funds requirement in the trading book for specific risk of debt instruments and for the 'default and migration risk';
- for the internal allocation of capital where the SA for the calculation of own funds requirements is used and, in this case, to additionally consider any other relevant information.

The survey was limited to banking regulation. Responses from 25 Member States were collected, which represent 99% of total credit RWEA in the EU. The answers received are presented in the annex to this report. The rest of the report is structure as follows:

- a high level summary of the answers received;
- descriptive statistics on the relevance of external ratings in RWEA calculations;
- proposed way forward based on the evidence collected.

2. High-level summary of questionnaire responses

In terms of references to external credit assessments in national legislation (question 1), **none of the answers received can be seen as introducing a mechanistic reliance to external credit ratings**, and no Member State foresees a reduction of these references in the future:

- Most Member States[4] report that they have not included such references in their national law apart from those resulting from the transposition of EU laws. One Member State clarified in its national law the notion of 'investment grade' introduced in Article 400(2) CRR[5].
- Two Member States reported references to external credit ratings in national law in connection with covered bonds; and one in connection with the state development bank, which uses external credit ratings to establish guarantee fees.
- Two Member States indicated a reference to external credit ratings as a relevant indicator for the credit risk assessment (such as non-performing status or as an indication of a possible credit risk worsening). In these two cases, the external credit ratings are only considered in conjunction with other indicators.

In terms of actions taken to **incentivise the use of the IRB** approach for 'institutions that are significant in terms of their size, internal organisation and the nature, scale and complexity of their activities' (question 2a), **most of the CAs did not see the need to introduce ad hoc incentives for using the IRB approach.** As a matter of fact, the answers recalled that there are already incentives to use the IRB approach, as it typically leads to a reduction of own funds requirements and more risk-sensitive capital requirements. As a consequence, LSIs typically do not use the IRB approach, while for SIs the benefits were justifying the investment and the cost of maintaining credit risk models for regulatory purposes. It is worth pointing out that the incentives mentioned by CAs are intended to reach a minimum coverage ratio for institutions willing to use the IRB. In this context, the final Basel III framework[6] introduces more flexibility in the adoption of the IRB approach, as '*The Committee recognises however, that, for many banks, it may not be practicable for various reasons to implement the IRB approach across all material asset classes and business units at the same time*' (CR30.46). As such, the implementation of the IRB approach should no longer be analysed at institution level, but at a more granular level, i.e. at exposure class level.

[4] 80% of respondents.

[5] This clarification is possible at national level as Article 400(2) CRR introduces an option to be exercised by competent authorities.

[6] https://www.bis.org/basel_framework/index.htm

In terms of actions taken to **incentivise the use of the internal methodologies for credit risk assessment (question 2b),** the answers note that generally LSIs do not rely on external credit ratings for **accounting and risk management purposes**. In many cases, the requirements of Article 79(b) CRD were transposed into national legislation and lead to on-site inspections to verify that internal methodologies have been developed consistently with the scale and complexity of the institutions. A number of CAs also report that there are few issuers and issues in the institutions' portfolios that have external ratings.

In terms of actions taken to **incentivise the use of the internal methodologies for credit risk assessment in the trading book** (specific risk of debt instruments, default and migration risk; please see question 2c in the questionnaire), many CAs note that the size of the trading book is negligible for institutions in their jurisdiction. For other cases, **where the size of the trading book is significant, institutions are usually larger and had the capacity to develop fully fledged internal models for market risk assessment**. As noted by one jurisdiction, the use of credit risk models in the trading book is largely covered in EU legislation. In this context, it is also worth mentioning that the final Basel III framework on market risk, the FRTB, will strengthen the link between the IRB framework and the own funds requirements in the trading book, and the EBA launched a consultation in July 2020 on the use of default probabilities and losses given default for default risk models under the Fundamental Review of the Trading Book[7]. Moreover, the Standardised Approach of the FRTB, denoted as Alternative Standardised Approach in the CRR2, introduces enhanced risk-sensitiveness and it is designed and calibrated to serve as a credible fall-back to the internal model approach.

Lastly, with respect to actions taken to incentivise the use of the **internal methodologies for credit risk** assessment in the case where the own funds requirements are calculated according to the **SA**, and to additionally consider **other relevant information** for assessing the allocation of internal capital (question 2d of the questionnaire), most of the answers referred to previous elements given in questions 2a and 2b: for institutions with a larger scale of business operations, the use of the IRB approach is intrinsically incentivised via lower own funds requirements and additional risk sensitivity, and in all cases the use of all relevant information is usually monitored via on-site inspection in the context of Pillar II. Further, the final Basel III framework introduces revisions in the Standardised Approach of the credit risk framework that require institutions using external credit ratings to conduct sufficient due diligence in order to reduce mechanistic reliance on external credit ratings.

[7] https://www.eba.europa.eu/regulation-and-policy/market-risk/regulatory-technical-standards-rts-default-probabilities-and-losses-given-default-default-risk-model

3. Relevance of external credit ratings in RWEA calculation

This section presents a number of descriptive statistics on the weight of external credit ratings in the computation of RWEA. The data source is the EBA Supervisory Reporting data as of 2019 Q4, which covers the largest institutions in the EU at the higher level of consolidation.

Overall, the share of RWEA derived through an external credit rating in the EU-27 remains limited, representing less than 10% of the total RWEA under the SA (see Table 1). In terms of relevance in the total credit risk framework, the weight of external credit rating based RWEAs is 4%.

Table 1. Share of RWEA derived through an external credit rating in the SA, EU-27

Category	Share of RWEA in the SA derived using an external rating	Memo: materiality (% total RWEA SA)
Total	**10%**	*100%*
Of which: exposures where external ratings are allowed:	**18%**	*48.0%*
- Sovereigns	12%	*9.0%*
- Institutions	54%	*3.6%*
- Corporates	15%	*34.8%*
- Covered bonds	58%	*0.4%*
- Claims on short-term credit assessments	97%	*0.1%*
Of which: exposures not externally rated	**0%**	*52%*

Note: The sovereign category includes the following exposure classes (the share of the RWA using an external credit rating is provided in brackets): 'Central governments or central banks' (11%), 'Multilateral development banks' (20%), 'Public sector entities' (22%) and 'Regional governments or local authorities' (18%).

Source: EBA COREP Supervisory Reporting.

A similar observation on the relevance of external credit ratings can be made on the IRB approach. Article 180(1)(f) CRR allows institutions to map their internal scale with the ones of an ECAI. The EBA published a report in November 2017 on the modelling practices[8], and investigated among other things the use of this option. Figure 11 of the report shows a limited use of this provision, with all the exposure classes reporting less than 5% of their overall exposure values based on an IRB model.

Regarding securitisation positions, the reporting requirements related to the revised securitisation framework became applicable as of the end of March 2020. Based on the supervisory data collected so far, 10% of the total RWEA in the securitisation framework are computed using the External Ratings Based Approach. The figures are to be interpreted with caution given the recent introduction of the reporting framework. In terms of order of magnitude, the RWEA calculated through the total securitisation framework represent around 7% of the total RWEA computed through the SA chapter of the CRR.

[8] https://eba.europa.eu/regulation-and-policy/model-validation/guidelines-on-pd-lgd-estimation-and-treatment-of-defaulted-assets

4. Recommendations

Against the background of the questionnaire responses and international developments in regulation, the relevance of a regular report on the reliance on external credit ratings seems limited, at least in the context of banking regulation, mainly because of the following:

a. References to external credit ratings are not material in Member States' law.

b. CRD requirements reducing reliance on external ratings were transposed into national law, namely those related to enhanced internal risk assessment capacity, promotion of internal models for own funds requirements when proportional, and reducing reliance on external credit ratings. These requirements are covered in Articles 77(1) and (3) and Article 79(b) CRD, as specified in the mandate. Strengthening or monitoring additional ad-hoc supervisory incentives seems of limited use as baseline principles to reduce reliance are implemented across the board.

c. The final Basel III framework[9] introduces revisions to the Standardised Approach of the credit risk framework to reduce mechanistic reliance on external credit ratings through enhanced due diligence. These new requirements should be implemented in the EU, as recommended by the EBA in its policy advice on credit risk to the EU Commission, published in August 2019[10].

d. The introduction of the new securitisation framework into the CRR aimed, inter alia, at limiting reliance on external credit ratings. This was achieved through the revised hierarchy of approaches, which set out formulaic approaches based on the credit risk drivers of the securitised exposures higher in the hierarchy, and by incorporating other relevant risk drivers into the External Ratings Based Approach, i.e. maturity and tranche thickness for non-senior exposures, and through due diligence requirements.

As a consequence, **it is recommended to remove the mandate in Article 161 (3) CRD** requiring the EBA, in cooperation with ESMA and EIOPA, to publish a biannual report on the reliance on external credit ratings in national law and how CAs meet their obligations under Article 77(1) and (3) and Article 79(b) CRD and the degree of supervisory convergence in that regard.

[9] Basel III: Finalising post-crisis reforms (bis.org)

[10] https://eba.europa.eu/sites/default/documents/files/Policy%20Advice%20on%20Basel%20III%20reforms%20-%20Credit%20Risk.pdf

Annex: Survey results

The EBA launched a survey among EU banking supervisors in December 2020 in the context of banking regulation, complemented by a second review in February 2021 to collect further views on Pillar II considerations. Responses from 25 Member States were collected, which represent 99% of credit RWEA in the EU.

Question 1:

Do you have in your own jurisdiction any national laws that refer to external credit ratings for regulatory purposes? If so, have you taken any particular action in order to reduce such references?

Member State	Answer
Austria	Confirmation that no national laws refer to external credit ratings for regulatory purposes.
Belgium	References to external ratings, i.e. Credit Quality Steps (CQS), are made in: - Our future new national legislation on covered bonds, which implements the Covered bond Directive ((EU) 2019/2162). - Our implementation of Article 400 (2) CRR, i.e. exemption of Article 395 (1) for sovereign bonds (…) with CQS 3 or higher. There are no plans to take any particular action in order to reduce such references.
Bulgaria	Bulgarian National Bank (BNB) does not have any national laws that refer to external credit ratings for regulatory purposes.
Croatia	There are no national laws that refer to external credit ratings for regulatory purposes. In Article 103 (3) of the Credit Institutions Act we have transposed the requirement of the Article 76 (2) CRD that states: ‘A credit institution shall ensure that adequate resources are allocated to the management of all material risks, including an adequate number of employees possessing the necessary knowledge and

Member State	Answer
	experience to be involved in risk management, and for the valuation of assets, the use of external credit ratings and internal models related to those risks.'
Czech Republic	No references to the external credit ratings for regulatory purposes have been identified in the current national laws.
Denmark	No.
Estonia	Yes, in the Credit Institutions Act external ratings are referred to in the context of acquisition and requirements for risk management and monitoring: Section 30. Notification of acquisition of holding and information to be submitted (3) The Financial Supervision Authority shall be informed of the name of the company in which the qualifying holding is being acquired or increased or is made a company controlled by the acquirer as well as the size of the acquired holding in this company and the following information and documents shall be submitted to the Financial Supervision Authority: 10) if possible, the ratings and public reports necessary for assessing the financial situation of the acquirer and the financial situation of companies related to him or her if the acquirer is a natural person, or credit ratings issued to the acquirer and its consolidation group if the acquirer is a legal person; Section 82. General requirements for risk management and monitoring (39) Upon assessment of credit risk and internal capital requirements a credit institution is required to take account of all the relevant information including if the calculation of capital requirements for the credit risk is based on the credit quality assessment of a rating agency or the lack of external credit quality assessment.
Finland	- Act on Credit Institutions Chapter 9, Section 9 (https://www.finlex.fi/fi/laki/kaannokset/2014/en20140610.pdf) Assessment of credit and counterparty risk by internal evaluation methods: A credit institution shall have sufficient internal methodologies for the assessment of the credit and counterparty risks with regard to the nature, scope and diversity of the activities of a credit institution. The internal methodologies shall not rely solely or mechanically on external credit ratings concerning the counterparty or financial instrument. A credit institution which is significant in the manner referred to in Chapter 10, Section 7 or 8 shall endeavour to use the internal classification methodologies to calculate the requirement of own funds and to assess at least such substantial credit risks that

Member State	Answer
	simultaneously concern a large number of significant counterparties as well as to assess the substantial counterparty risk pertaining to debt financial instruments in the consignment stock, if the counterparty risk concerns a large number of various counterparties. - Act on Credit Institutions Chapter 9, Section 10 Credit and counterparty risk: The granting of credit is based on sound and well-defined criteria. The principles and procedures concerning the processes for approving, amending, renewing, and re-financing credits shall be clearly established and documented. A credit institution shall have internal methodologies that enable them to assess the individual credit and counterparty risks. In its internal assessment methodologies it shall not rely solely or mechanically on external credit ratings. Where calculations concerning own funds of a credit institution are based on an external credit rating or on the fact that a credit risk is unrated, a credit institution shall additionally determine the amount of own funds required to be allocated to the said risk. A credit institution shall ensure that the ongoing administration and monitoring of the various credit risk-bearing portfolios and exposures of institutions is operated through effective systems; it shall have processes for identifying and managing problem credits and for making adequate value adjustment entries and loss reserves thereof. The credit receivables have to be kept adequately decentralised in accordance with the target market of a credit institution and the credit-granting strategy approved by the Board of Directors of a credit institution. - Act on Credit Institutions Chapter 11, Section 2: Taking into account the nature, scope and diversity of the activities of a credit institution, the Financial Supervisory Authority shall in its supervisory activities promote the internal assessment of customer credit ratings by a credit institution and the use of internal credit ratings in the solvency management of a credit institution in particular in respect of the counterparty risks connected to credit granting and the special risk connected to traded securities as well as the use of internal procedures in the management of the liquidity of a credit institution.
France	In order to reduce the use of external ratings by French institutions, Article 77 CRD was transposed into Article 114 of binding order of 3 November 2014 encouraging institutions to build their own models to evaluate credit risk related to their exposures to counterparties, bonds and securitisation exposures or to the credit risk at portfolio level. It is added that internal models to evaluate credit risk shall not rely exclusively on external ratings, as all relevant information shall be taken into account when calculating capital requirements on this basis.
Germany	“N/a”

Member State	Answer
Greece	Bank of Greece does not have any national law that refers to ECAIs for regulatory purposes.
Hungary	In the Hungarian legislation there is no rule which refers to external credit ratings for regulatory purposes. However, there is a requirement in the Banking Law, which requires the MNB to encourage banks to develop internal models.
Ireland	National laws governing the use of external credit ratings in Ireland are limited to the transposition of the requirements of Directive 2013/36/EU - Capital Requirements Directive CRD IV ('CRD IV'). CRD IV is transposed through Statutory Instrument (S.I) 158/2014. The European Union (Capital Requirements) Regulations 2014. Part 6, Chapter 2 of S.I. 158 specifically requires the following in relation to the use of external credit assessments: - Paragraph 64 (treatment of risks – risk committee and combined committee) requires that institutions shall ensure that their management bodies shall be actively involved in and ensure that adequate resources are allocated to the use of external credit ratings; - Paragraph 65 (Internal approaches for calculating own funds requirement) requires that the Bank shall, taking into account the nature, scale and complexity of the activities of institutions, monitor that those institutions do not solely or mechanistically rely on external credit ratings for assessing the creditworthiness of an entity or financial instrument; - Paragraph 67 (credit and counterparty risk) requires that internal methodologies used for the purposes of assessing credit risk of exposures shall not rely solely or mechanistically on external credit ratings.
Italy	No, the use of external credit ratings for prudential purposes is regulated by EU Regulation 575/2013 (CRR), directly applicable to banks. Circular 285 of the Bank of Italy requires banks not to exclusively rely on external ratings for the purposes of assessing of counterparties' creditworthiness. In accordance with the provisions on internal governance, the management body shall ensure that in the risk management process, limited reliance is made on external ratings by requiring that for any risk categories an internal and independent assessment is performed. Moreover the Circular 285 requires banks to use internal methodologies in order to evaluate credit risk towards debtors, securities, securitisations, and at overall portfolio level in assessing the creditworthiness of the exposures; therefore, the assessment may lead to different outcomes from the one reached by an ECAI. Furthermore, institutions are required to analyse – at least on a yearly basis – the consistency between ECAI ratings and the bank's credit decisions taken on the basis of its own methodologies. The outcome of such an analysis is formalised in a report of the management body in its management function transmitted to the management

Member State	Answer
	body and to the statutory auditor. Should the cases where the bank's choices differ from the ECAI's evaluation be frequent, the report is transmitted to the competent authority.
Latvia	Financial and Capital Market Commission Regulation on credit risk management refers to external credit ratings for regulatory purposes, but only to be consistent with CRD requirements. The regulation sets out the requirement to not rely solely or mechanistically on external credit ratings.
Lithuania	No specific national laws or regulations related to external credit ratings for regulatory purposes. Article 77(1) and (3) and Article 79(b) are transposed into the national legislation without additional clauses, only saying that 'Where the own funds requirement is determined on the basis of the rating of an External Credit Assessment Institution or the fact that the position is not rated, the bank shall additionally take into account other relevant information when assessing its internal capital allocation.'
Luxembourg	Subject to our comment below, we are not aware of any specific national law that would refer to external credit ratings for credit risk assessment purposes. However, the covered bond section of the Luxembourg law on the financial sector of 1993 subjects mortgage bond banks to investment restrictions for the eligible asset pool, whereby those assets shall meet certain minimum rating requirements. In respect to covered bond banks, no specific action has been taken.
Malta	Malta's national legal framework does not make reference to the use of external credit ratings for regulatory purposes which go beyond the CRD framework.
Netherlands	In the Dutch law on financial supervision (Wet Financieel Toezicht), there are a few references to external credit ratings. These references are of immaterial nature. We have not taken any particular action to replace these references.
Poland	Under the Polish banking regulation, the sole reference to the external credit rating identified is the mechanism of determining the minimum fee of Bank Gospodarstwa Krajowego (Polish state development bank, 'BGK') sureties and guarantees. This mechanism is set by the regulation of the Council of Ministers of 8 June 2012 on the fees for the sureties and guarantees granted by the State Treasury ('the Regulation'). It is designed for the BGK's sureties and guarantees, which do not constitute a state aid according to the European Commission's stance, and which have values higher than EUR 10,000,000 but not exceeding EUR 30,000,000.

Member State	Answer
Portugal	The ‘Legal Framework of Credit Institutions and Financial Companies’ as approved by Decree Law No 298/92 (‘RGICSF’) constitutes, together with directly applicable EU legal acts (e.g. Regulation (EU) No 575/2013 (‘CRR’)) the basic law governing the access to the activity of credit institutions as well as the exercise of their supervision. In this vein the principles enshrined in relevant EU legal acts, and in particular the principles in Articles 77(1) and (3) and 79(b), on reducing reliance on external credit ratings for regulatory purposes, are envisaged in RGICSF (Articles No 115-N(2) and 116-AE(9) and (10)) as a matter of national transposition of the CRD. No specific action is envisaged to specifically address reduction of references to current external ratings provisions, though it should be noted, as mentioned, that the banking prudential framework is mainly EU-based.
Romania	No national laws, besides the provisions of the CRR/CRD framework, that refer to external credit ratings for regulatory purposes.
Slovenia	There is no banking regulation in our national legislation that includes references to external credit ratings for regulatory purposes. Provisions of Articles 77(1) and (3) and 79(b) CRD which relate to the reduction of the banks' reliance on external credit ratings were transposed into the national law with the Banking Act – ZBan-2. In addition, the Regulation on credit risk management at banks and savings banks also includes such type of provision: ‘When external credit ratings are the bank’s main criterion in the assignment of debtors or exposures to credit rating grades, the bank shall also take account of other relevant information set out in its internal methodology for classifying obligors and exposures.’ Some references to external credit ratings are included in the Guidelines relating to the use of an expected credit loss model and the application of valuation rules for certain accounting items as well. Guidelines were issued by the Bank of Slovenia to help banks in the application of IFRS9 (at the time of introduction of this Standard). However, guidelines are used for accounting purposes and are under consideration to be abolished.
Spain	Regarding the credit risk area within banking regulation, national laws that include references to external credit ratings for regulatory purposes mainly reflect the international regulation in this regard. As examples: 1) National laws related to the transposition of Directive 2013/36/UE. Basically:

Member State	Answer
	- Law 10/2014 of 26 June 2014 on the regulation, supervision and solvency of credit institutions. - Royal Decree 84/2015 of 13 February 2015 implementing Law 10/2014 of 26 June 2014 on the regulation, supervision and solvency of credit institutions. The main reduction of references to external credit ratings in prudential regulation will take place through the implementation in Europe of the reform of the Standardised Approach for credit risk at Basel level, expected in January 2023. 2) Annex 9 'Credit risk analysis, allowances and provisions' of Circular 4/2017 of 27 November to credit institutions on public and confidential information rules and formats (accounting rules), which reflects IFRS9. It states, for example, that: - the existence of an external credit rating that shows that the borrower is in default shall be considered as an indicator for the transaction to be classified as non-performing for reasons other than arrears. In this case, the reference is not only to external ratings but also internal ratings could be used as an indicator, therefore reducing the over-reliance on external ratings. - an actual or expected significant decrease in the main transaction´s external credit rating could be an indicator that the credit risk has increased significantly since initial recognition, which may lead to the classification of the transaction as performing under special monitoring. In this case, the reference is not only to external ratings, but also other external market indicators of credit risk for a particular transaction or similar transaction with the same expected life could be used as an indicator, therefore reducing the over-reliance on external ratings. 3) Law 15/2011 of 16 June 2011 (amending certain rules for the implementation of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies).
Sweden	Sweden does not have any national law that refers to external credit for regulatory purposes.

The following questions address the mandate 'those reports shall outline how the competent authorities meet their obligations under Article 77(1) and (3) and Article 79(b). Those reports shall also outline the degree of supervisory convergence in that regard.'

Question 2a: refers to Article 77(1) CRD

Please describe how you have encouraged institutions that are significant in terms of their size, internal organisation and the nature, scale and complexity of their activities to develop internal credit risk assessment capacity and to increase the use of the internal ratings based approach for calculating own funds requirements for credit risk where their exposures are material in absolute terms and where they have at the same time a large number of material counterparties.

Member State	Answer
Austria	Article 79 letter b CRD is transposed in the national regulation on credit institution risk management (Pillar 2) – see Section 5 (2) KI-RMV: 'credit institutions must have in place internal methodologies that enable them to assess the credit risk of exposures to individual obligors, securities or securitisation positions and credit risk both at the portfolio level and the level of groups of connected clients. In particular, internal methodologies shall not rely solely or mechanistically on external credit ratings. Where own funds requirements are based on a rating by an External Credit Assessment Institution (ECAI) or on the fact that no rating exists for a risk position, this shall not exempt credit institutions from the obligation to additionally consider other relevant information for assessing their allocation of internal capital.' The largest institutions in AT (mostly SIs) use the IRB approach. Those institutions under our direct supervision that apply the Standardised Approach for credit risk use adequate internal models under Pillar 2 which are assessed during credit risk on-site examinations. In our experience, banks do not rely solely or mechanistically on external credit ratings. This is also verified in the course of credit risk on-site examinations.
Belgium	- For the CRR's first implementation, clarification that all our large institutions were expected to adopt an IRB approach, also for sovereign exposures. And none of our IRB banks were allowed to use the SA for their sovereign exposures. - Requirement that 80% of the exposures were covered by the IRB approach at the end of the roll-out period, to avoid cherry picking.

Member State	Answer
	- Finally, checks are performed for possible cherry picking when banks are asked to apply the SA approach for non-material exposures. And we refuse it in the majority of cases when we considered that it could bias banks' risk assessment and capital requirement.
Bulgaria	Ordinance No 7 of 24 April 2014 on Organisation and Risk Management of Banks, Article 18 (1) and (2), as follows: Article 18: '(1) Banks that are particularly significant in terms of their size, internal organisation and the nature, scale and complexity of their activities shall provide the necessary prerequisites for: 1. internal credit risk assessment capacity and for the use of the internal ratings based approach where their exposures are material in absolute terms and where they have at the same time a large number of material counterparties; 2. internal specific risk assessment capacity and for the use of internal models for specific risk of debt instruments in the trading book, together with internal models for default and migration risk where their exposures to specific risk are material in absolute terms and where they have a large number of material positions in debt instruments of different issuers. (2) Paragraph 1 shall be applied without prejudice to the fulfilment of the criteria for authorisation to use: 1. Internal Rating Based Approach under Part Three, Title One, Chapter Three, Section I of Regulation (EU) No 575/2013'
Croatia	Article 77 (1) CRD is transposed in the Credit Institutions Act, in Article 115 (1): 'Credit institutions that are significant in terms of their size, internal organisation and the nature, scale and complexity of their activities shall, without prejudice to the fulfilment of the criteria laid dawn in Part Three, Title I, Chapter 3, Section 1 of Regulation (EU) No 575/2013, take appropriate measures to develop internal credit assessment capacity and to use the internal ratings based approach for calculating own funds requirements for credit risk: a) where their exposures are material in absolute terms, and b) where they have at the same time a large numbers of material counterparties. In the Republic of Croatia only one credit institution uses the IRB approach for calculating own funds requirements for credit risk. Other credit institutions are using the Standardised approach, which is for them considered adequate.
Czech Republic	The Significant Institutions in the Czech Republic already use the IRB approach. In some cases, under IRB the PPU is used – nevertheless this mostly concerns sovereign exposures where fixed regulatory RW of 0% is used.
Denmark	It is not deemed necessary to carry out specific undertakings considering the portfolio characteristics of Danish credit institutions and existing practices for risk-classification of exposures.
Estonia	Banks under Finantsinspektsioon supervision are relatively small with simple business models. At the moment all of them are calculating their own fund requirements according the standardized approach for credit risk

Member State	Answer
Finland	All relevant Significant Institutions and some LSIs are already using IRB approach in Finland.
France	Most Significant Institutions (SI) in France already use the IRB approach. Internal credit risk assessment capacity is also mostly used for credit risk management purposes. Article 114 of binding order of 3 November 2014 encourages the development of internal methodologies (please see Q1).
Germany	On internal credit risk assessment capacity (Pillar 2): German institutions are not only encouraged, but also, according to the Minimum Requirements on Risk Management (MaRisk), required to establish an appropriate and effective risk management (including credit risk), on the basis of which an institution shall continuously safeguard its internal capital adequacy. Section 25a (1) of the German Banking Act (KWG) is the legal basis for the regulation of risk management and BaFin has expanded upon the requirements of Section 25a KWG in the circular MaRisk. MaRisk is a proportionate framework, which is aimed at the management of all material risks of an institution and it also outlines BaFin's expectation on credit risk management / credit risk assessment capacity. The philosophy of proportionality is important with regard to risk management standards for German institutions as specified in KWG and MaRisk. The risk management processes and mechanisms are to be proportionate to the nature, scale, and complexity of risks inherent in the business model and the institution's activities. In practice, this means that institutions with more complex credit risk and material credit risk exposures and / or a large number of material counterparties are required to apply more sophisticated credit risk quantification methods in their internal capital adequacy assessment process. The suitability of credit risk quantification methods used in the institutions' internal capital adequacy assessment processes is routinely assessed in on-site inspections conducted by the Bundesbank and BaFin. On the use of the IRBA (Pillar 1): General background on the use of IRBA by German banks: After market risk modelling was introduced successfully, German institutions were interested to show the viability of their internal credit risk approaches for Pillar 1 purposes and participated in several impact studies. In the end, the implementation of the IRB approach with potential capital reductions compared to the Standardised Approach and the prospect of more risk-sensitive capital requirements were sufficient to initiate applications for IRB approval by a considerable number of institutions. In addition, BaFin and the

Member State	Answer
	Bundesbank engaged in intense discussions with the industry on what the Basel II and former CRD requirements actually meant for the particular situation in German institutions, which led to a broad common understanding and harmonisation in terms of the application of the requirements under the IRB approach. Lastly, the requirement to eventually achieve an IRB coverage of at least 92% of the entire credit risk portfolio (in terms of EAD and RWEA) led to the development of additional rating systems for further types of exposures once an institution had started the implementation of the IRB approach. The existence of legally independent Sparkassen and Landesbanken, respectively, with similar business models but different regional focus led to the development of a system of pool models where the obligor and default data is collected by a central service provider which then develops and continually maintains the models. These pool models are now used by several institutions. Supervision encouraged this structure by an efficient assessment and approval approach for such pool models. The comparatively broad IRB implementation in Germany particularly among larger institutions resulting from the aforementioned considerations and the responsibility of the ECB in terms of supervising Significant Institutions (SIs) both are significantly reducing the potential scope of application of the requirements in accordance with Article 77(1) CRD IV. Current process on how to encourage institutions to use the IRBA: BaFin has established an internal process for identifying the institutions that fall into the scope of application of the requirements of Article 77(1) CRD IV on a yearly basis. Within this process, out of the subset of Less Significant Institutions (LSIs) those institutions are identified that are considered significant in terms of their size, internal organisation and the nature, scale and complexity of their activities based on a set of predefined criteria. Where identified institutions do not already use the internal ratings based approach (IRB approach) for calculating own funds requirements for credit risk, the horizontal function informs the divisions that are responsible for supervising the respective identified institutions accordingly. In order to encourage institutions to increase the use of the internal ratings based approach for calculating own funds requirements for credit risk, those divisions will then ask the individual institutions if they plan to use the IRB approach in the future or, otherwise, for what reason they currently do not plan to use it. The process thereby ensures an ongoing dialogue with those institutions that are within the scope of application of Article 77(1) CRD IV in terms of their intention to develop additional internal credit risk assessment capacity and to increase the use of the IRB approach.
Greece	In Greece there is just one SI which implements the foundation IRB approach. All other institutions, SIs and LSIs, are implementing the Standardised Approach. Nevertheless, we have encouraged banks to develop internal models for the purposes of the regulatory stress test exercises.

Member State	Answer
Hungary	As per MNB guidelines, all counterparties need to be rated and ratings should be periodically, at least once a year, updated. It is not expected, however, that these ratings be assigned to a probability of default, or should be used in credit risk capital requirement. For large Hungarian banks MNB requires an IRB (mostly advanced IRB) capital requirement calculation at least in Pillar 2 in order to measure their own risk more accurately. This is an earlier requirement, goes back 8–10 years. For the last couple of years almost all large banks have AIRB calculation for most of their significant portfolios in Pillar 2. These calculations are challenged each year by MNB’s own AIRB calculations, using supervisory benchmark models and EBA benchmark risk parameters for low default portfolios. The results and the findings connected to banks’ own models are shared with the banks and MNB encourages them to constantly improve their internal calculation. For smaller banks such an explicit requirement does not exist (taking into account the principles of proportionality), however taking a risk-based approach MNB prepares an annual AIRB calculation of credit risk for selected smaller banks too, and shares the results with them.
Ireland	The majority of institutions, that are material in terms of size, which are supervised directly by the Central Bank of Ireland (or jointly supervised with the European Central Bank Single Supervisory Mechanism (SSM)) already use the internal ratings based approach (IRB) for credit risk purposes. In Ireland, the use of the IRB approach has been in place in the most material institutions in terms of credit exposures since the implementation of the Basel II requirements into European and Irish law. Under current supervisory practices, institutions are not specifically encouraged or discouraged to increase the use of the IRB approach. Following the financial crisis, competent authorities’ and institutions’ focus has been on enhancing and repairing the existing credit risk internal models in line with the requirements of the EBA IRB repair programme and the enhancement of the internal model landscape and reduction of non-risk based risk weighted asset (RWA) variability. This was a focus of the SSM Targeted Review on Internal Models (TRIM) project. This, in tandem with assessing new applications for the use of internal models for new or expanding institutions post Brexit, has been the key focus of the Central Bank of Ireland rather than specifically encouraging increasing the use of the IRB approach for calculating own funds requirements. Finally, it is also the case that as part of certain individual institutions’ remediatory actions across their model landscape, supervisors have supported banks in a reversion to the Standardised Approach for credit risk for some immaterial portfolios, in order to ensure proportionate focus of internal model expertise in the institutions to the most material exposures rated under the IRB approach. The

Member State	Answer
	level of exposures rated using the IRB approach in respective institutions is closely monitored by the Central Bank of Ireland/SSM supervision teams as applicable. Internal credit risk assessment capacity At a high level, for banks which are classified as Significant Institutions (SIs) in terms of their size and complexity, the extent of the engagement on this matter is determined by the ECB SSM as Competent Authority for prudential supervision of these institutions. As part of the dialogue with the institution and where relevant in tandem with the SSM, discussions on the topic of building internal credit assessment capacities will take place throughout the year as part of the ongoing supervisory dialogue. During this process, the risk levels of the SIs will be assessed under a number of categories (e.g. portfolio, sub-portfolio, sectoral, individual levels). Furthermore, supervisors will assess and investigate the risk controls which institutions have put in place in order to manage their risk. A review of the institutions' credit risk policies and procedures occur as part of this work. From this assessment, determinations are made as to how institutions are managing their risk and if controls in place are adequate given the level of risk. Should any concerns emerge, these are raised with the institution. Furthermore, outside of the supervisory dialogue process, JSTs engage with institutions and continuously assess if credit risk assessments and risk quantification models are deemed appropriate, this includes the level of reliance (or lack thereof) on external credit ratings. These engagements are completed via off-site engagement, on-site inspections, Comprehensive Assessments, deep-dives, internal model investigations, ongoing model monitoring, etc. The key areas of focus will include risk appetite, adequacy of the risk frameworks and controls, oversight and governance as well as routines and reporting mechanisms for inter alia concentration risks, provisioning and charge-offs, timeliness and data quality and the blending of model and judgmental components.
Italy	The incentives for large institutions to develop internal models for calculating capital requirements are embedded in the prudential regulation: capital requirements based on internal estimates are potentially lower and more risk sensitive than those based on the Standardised Approach.
Latvia	Less Significant Institutions in Latvia do not apply IRB models for credit risk own funds requirements due to the nature, scale and complexity of institutions' processes. We do not have specific guidance in this respect for O-SIIs that apply the Standardised Approach, however, we have the Regulation on granting permissions for using internal models, approaches and methods according to Regulation (EU) No 575/2013.

Member State	Answer
Lithuania	Two out of three of the largest credit institutions in Lithuania, which also constitute over 60% of the banking market, already use IRB approaches for calculation of own funds requirements. They are directly supervised by the ECB. Other market players are too small in their size, scale and complexity to develop comprehensive rating models.
Luxembourg	We have relied on Article 77 CRD IV, as transposed in the CSSF Regulation 15-02 (in particular Article 9(2) thereof), to perform on-site inspections to verify that banks have developed internal credit risk assessment capacity. As regards the increased use of the IRB approach, the CSSF has not yet taken any action given the limited scale and complexity of Less Significant Institutions in Luxembourg.
Malta	It can be highlighted that until now, the MFSA did not feel the need to encourage banks to develop internal credit risk assessment capacity and increase the use of the internal ratings based approach. None of the less significant banks make use of the IRB approach. Also most banks are small and have small loan books on which it is difficult to model, there might be a lack of in-house knowledge/expertise (outsourcing is expensive) and also lack of reliable and applicable data on which to model. However, there was a particular instance whereby the Authority had asked for specific data related to their estimation of LGDs and PDs. This was carried out in order to assess whether the bank carries out an assessment of whether the Standardised Approach underestimates its credit risk. This was also a result of the peculiarities of the bank’s loan book, which is mainly based on trade finance. Thus, while the Authority did not push for the adoption of internal models for regulatory reporting/capital determination purposes, we have in certain cases assessed whether such internal models are used, particularly to determine whether the Standardised Approach results in an underestimate of the capital at risk for credit risk.
Netherlands	Institutions have not been encouraged to switch from the Standardised Approach to the IRB approach in recent years, mostly because the Dutch banking landscape already has a relatively high IRB coverage and most significant banks already use the IRB approach. Moreover, under the Final Basel III Framework it will be possible to use the internal ratings based approach for calculating own funds requirements for credit risk for particular asset classes, while applying the Standardised Approach to other asset classes. This will enable banks to increase the use of internal models for particular exposures for which an internal model is suitable. On the other hand, the Final Basel III Framework will also limit the use of the IRB approach for a number of exposure classes.
Poland	The PFSA assesses banks' applications for the use of internal methods, carries out activities in the post-application phase and cooperates with banks in the pre-application phase. It should be strongly emphasised, however, that the decisions of banks to use the internal methods are autonomous.

Member State	Answer
	Please also see information regarding the general approach as to the internal methods communicated in the Recommendation W of the PFSA, which specifies that bearing in mind the content of recital 42 CRR and Article 77 (1) and (3) CRD IV, the PFSA expects that as a result of implementing the Recommendation and improving the quality of model risk management, banks will undertake activities aimed at increasing the use of internal risk methodologies also as part of the calculation of capital requirements for regulatory requirements to ensure greater consistency between the level of capital requirements and the bank's risk level.
Portugal	No specific action is envisaged to specifically address reduction of references to current external ratings provisions, though it should be noted, as mentioned, that the banking prudential framework is mainly EU-based. Taking into account those principles in RGICSF, supervisory teams assess, monitor and challenge the use of credit rating systems by the institutions as part of their ongoing monitoring responsibilities.
Romania	In Romania, there are two credit institutions using IRB for calculating own funds requirements for credit risk, the rest of the credit institutions are using the Standardised Approach, which we consider sufficiently conservative. Also, in the ICAAP process, a large majority of the banks are using internal models for assessing credit risk and the Pillar 2 requirement for credit risk, models which are assessed by the supervisory authority in SREP.
Slovenia	Banks could be divided into three groups: (i) significant banks in terms of their size, scale and complexity, which developed their own ‘IRB like’ models, (ii) subsidiary banks, that use adjusted internal models of their European parent banks and (iii) LSIs that do not have either resources and capacity or representative portfolios to develop internal models. During the supervisory dialogues and designated on-site inspections, Bank of Slovenia strongly encouraged the first group of banks above to develop ‘IRB like’ models to better measure, assess and mitigate their credit risk, however Bank of Slovenia did not explicitly encourage these banks to use the internal ratings based approach for calculating own funds requirements.
Spain	The Spanish LSIs, in general, do not rely on external ratings for accounting and risk management purposes. Instead of it, they perform individual assessment of their creditors and, in many cases, they have relevant knowledge of them as their geographical scope is regional. For the purpose of calculating own funds requirements for credit risk, Spanish LSIs are not sufficiently significant in terms of their size, internal organisation and nature, scale and complexity of their activities to apply the internal ratings based approach for credit risk.

Member State	Answer
	In order to provide additional information on the provisions of Circular 4/2017 we would like to highlight relevant paragraphs of the Annex 9 ‘Credit risk analysis, allowances and provisions’ of Circular 4/2017 also mentioned in answer 2b), encouraging entities to develop an internal credit risk assessment capacity. Paragraphs 47 (a) and 48 (a) require individual credit risk assessment for exposures that are above pre-defined quantitative thresholds either in absolute terms or in relative terms. These thresholds are fixed by the entities allowing them to take into account their size, internal organisation as well as the nature, scale and complexity of their activities. These paragraphs also require entities to predefine the qualitative factors that lead to individual assessment. In addition, paragraph 46 states that institutions must develop methodologies for the estimation of all allowances and provisions for non-performing or performing-under-special-monitoring transactions subject to individual estimation.
Sweden	SFSA has not seen the need to encourage institutions to increase their use of the IRB approach. Instead, Significant Institutions have applied on their own initiative.

Question 2b: refers to CRD Article 79(b)

Please describe how you have encouraged institutions to develop internal methodologies that enable them to assess the credit risk of exposures to individual obligors, securities or securitisation positions and credit risk at the portfolio level, without relying solely or mechanistically on external credit ratings.

For this question, it is considered that there is sole or mechanistic reliance on credit ratings (or credit rating outlooks) when an action or omission is the consequence of any type of rule based on credit ratings (or credit rating outlooks) without any discretion. This is based on the definition introduced in the 2014 report on mechanistic references to credit ratings in the ESAs' guidelines and recommendations[11]. A particular focus is expected on institutions calculating their own funds requirements according to the Standardised Approach for credit risk.

Member State	Answer
Austria	Article 79 letter b CRD is transposed in the national regulation on credit institution risk management (Pillar 2) – see Section 5 (2) KI-RMV: 'credit institutions must have in place internal methodologies that enable them to assess the credit risk of exposures to individual obligors, securities or securitisation positions and credit risk both at the portfolio level and the level of groups of connected clients. In particular, internal methodologies shall not rely solely or mechanistically on external credit ratings. Where own funds requirements are based on a rating by an External Credit Assessment Institution (ECAI) or on the fact that no rating exists for a risk position, this shall not exempt credit institutions from the obligation to additionally consider other relevant information for assessing their allocation of internal capital.' The largest institutions in AT (mostly SIs) use the IRB approach. Those institutions under our direct supervision that apply the Standardised Approach for credit risk use adequate internal models under Pillar 2 which are assessed during credit risk on-site examinations. In our experience, banks do not rely solely or mechanistically on external credit ratings. This is also verified in the course of credit risk on-site-examinations.
Belgium	For the hierarchy of approaches for securitisation, the CRR is followed. It is only specified that banks were expected to use the internal rating approach for one securitised exposure as soon as some of its underlying assets are subject to an IRB approach – when they are not securitised (i.e. even if some other underlying assets are under SA approach).

[11] Report of the JC ESA on mechanistic references to credit ratings in the ESAs' guidelines and recommendations

Member State	Answer
Bulgaria	Ordinance No 7 of 24 April 2014 on Organisation and Risk Management of Banks, Article 7 (2) and (5), as follows: Article 7: ‘(2) The bank shall have internal methodologies that enable it to assess the credit risk of: 1. exposures to individual obligors; 2. securities positions; 3. securitisation exposures; and 4. credit risk at the portfolio level. (5) Internal methodologies for credit risk assessment shall not rely solely or mechanically on external credit ratings.’
Croatia	Article 79(b) CRD is transposed in the Decision on governance arrangements (OG 96/18, 67/19 and 145/20) Article 32, paragraphs 5 and 6: ‘5. A credit institutions shall determine an internal methodology which enables an assessment of credit risk exposure to individual debtors, securities or securitisation positions and credit risk at the portfolio level. 6. The internal methodology referred to in paragraph (5) of this Article shall not be based exclusively on a rating by an External Credit Assessment Institution.’ Only a few companies operating in Croatia have external credit ratings and therefore Croatian credit institutions have developed their internal methodologies that enable them to assess the credit risk of exposures to individual obligors or at the portfolio level. In such a way they do not rely solely or mechanistically on external credit ratings.
Czech Republic	The national regulation (executive decree) has always contained the strict rules for credit risk management applicable for all credit institutions and they are regularly supervised. The rules require that each transaction is evaluated in terms of its amount and complexity and the minimum list of aspects to be evaluated, depending on the type of product and counterparty, includes in particular: - the financial and economic situation of the counterparty; - the purpose of the transaction; - the sources of repayment, including the ratio of the exposure’s amount to the counterparty’s receipts, and including an evaluation of such receipts in terms of their permanence and binding nature; - the quality and adequacy of the protection; - the situation in the counterparty’s economic sector; if the exposure is collateralised by funded credit protection, the liable entity shall also evaluate the ratio of the exposure’s amount to the funded credit protection’s amount; - the macroeconomic conditions in the country where the counterparty has its registered office, including the phases of the economic cycle; - the terms and conditions under which the transaction is to be executed;

Member State	Answer
	- the applicable law, in particular where foreign legislation is concerned; and - in the case of financing of a certain asset, also the ratio of own resources used by the counterparty to finance the asset. Credit risk mitigation cannot substitute an evaluation of the financial and economic situation of the counterparty. Moreover, the Standardised Approach is used only by smaller credit institutions. The issue of potential mechanistic reliance on credit ratings is negligible in the Czech Republic in any case, as there are only a few issuers and issues in the banks´ portfolios that have an external rating.
Denmark	It is not deemed necessary to carry out specific undertakings considering the portfolio characteristics of Danish credit institutions and existing practices for risk classification of exposures.
Estonia	In the Estonian market banks are not highly relying on external credit ratings since only a few companies operating in Estonia have external ratings. Estonian banks have developed their internal methodologies that enable them to assess the credit risk of exposures to individual obligors and credit risk at the portfolio level, without relying solely or mechanistically on external credit ratings.
Finland	FIN-FSA Regulations and guidelines 4/2018 Management of credit risk by supervised entities in the financial sector (https://www.finanssivalvonta.fi/globalassets/en/regulation/fin-fsa-regulations-and-guidelines/2018/04_2018/2018_04.m2_en.pdf) Chapter 4.4 Measurement of credit risk and the management information systems (63) The measurement of credit risk shall take account of the specific nature of the claims, their contract terms, the existence of collateral, the probability of payment default and possible market movements affecting the value of the claims. (64) Supervised entities must, regardless of whether they use internal models in the calculation of capital requirements for credit risk, assess and monitor the quality of their credit portfolios by a risk rating system which takes the creditworthiness of the customers into account. (65) The risk rating system shall hold so many categories that it can separate both different credit risks in well-managed credits and credit risks in doubtful credits. (66) The risk rating system shall reflect changes in the credit risks. Deterioration of a customer's payment capacity shall lead to an adjustment of its risk rating and a thorough review of its credits. Weaker customers must be included in more active monitoring. (67) A function that is independent of the credit granting shall be responsible for making the rating decisions. This independent function shall also regularly ensure that the rating reflects the actual, prevailing conditions. (68) Supervised entities must have information systems and analytical techniques that provide the senior and executive management with adequate reliable, detailed and timely information on the composition of the credit portfolio, including identification of any concentrations of risk. (69) Supervised entities must have a credit risk rating process in

Member State	Answer
	accordance with chapter 4.3.2, paragraphs (42)–(48) of the EBA Guidelines on credit institutions' credit risk management practices and accounting for expected credit losses. 4.6.2 Customer monitoring (83) Supervised entities shall establish principles for the monitoring of customers, collateral and guarantees. The principles shall describe how problem customers are identified as early as possible and the procedures for treatment of problem customers of various degrees. Where special terms, or covenants, are applied in lending, the supervised entity must have processes, systems and responsible persons to conduct the requisite regular monitoring and implementation of documented measures. (84) In making a decision on measures or forbearances, the supervised entity must consider the borrower's financial position and current capacity to repay the credit. (85) The supervised entity shall appoint the persons that are to be responsible for the monitoring of credits and collateral. These persons shall ensure that the persons responsible for the internal risk rating are immediately provided with information on changes in customers' financial position as well as the timely information needed to update the ratings.
France	While Less Significant Institutions (LSI) in France mainly use the SA approach, they have already developed internal credit risk assessment capacity for credit risk management purposes. Article 114 of binding order of 3 November 2014 encourages the development of internal methodologies (please see Q1). Off-site supervision and on-site supervision also regularly assess the robustness of internal credit risk assessment methodologies.
Germany	German institutions are not only encouraged, but also, according to the Minimum Requirements on Risk Management (MaRisk), required to establish an appropriate and effective risk management (including credit risk), on the basis of which an institution shall continuously safeguard its internal capital adequacy. Section 25a (1) KWG is the legal basis for the regulation of risk management and BaFin has expanded upon the requirements of Section 25a KWG in the circular MaRisk. MaRisk is a proportionate framework, which is aimed at the management of all material risks of an institution and it also outlines BaFin's expectation on credit risk management / credit risk assessment capacity. The philosophy of proportionality is important with regard to risk management standards for German banks as specified in KWG and MaRisk. The risk management processes and mechanisms are to be proportionate to the nature, scale, and complexity of risks inherent in the business model and the institution's activities. In practice, this means that institutions with more complex credit risk and material credit risk exposures and / or a large number of material counterparties are required to apply more sophisticated credit risk quantification methods in their internal capital adequacy assessment process. The suitability of credit risk quantification methods used

Member State	Answer
	in the institutions’ internal capital adequacy assessment processes are routinely assessed in on-site examinations conducted by the Bundesbank and BaFin. MaRisk provides comprehensive requirements regarding the credit risk process from granting and monitoring to restructuring. With regard to the usage of external credit assessments MaRisk lays down as part of the requirements relating to credit business processes: ‘The use of external credit assessments shall not relieve the institution of its obligation to form its own opinion on counterparty and credit risk and to factor its own knowledge and information into the credit decision.’ The appropriateness of these processes is routinely assessed in on-site examinations conducted by the Bundesbank and BaFin. When it comes to the methods used in the institutions’ internal capital adequacy assessment process (which include credit risk quantification methods at portfolio level) MaRisk states more precisely that: ‘Parameters determined on the basis of external data and assumptions taken over uncritically from other sources shall not be used in … the determination of risk or the aggregation of risk. … If the assumptions regarding parameters of the risk calculation or risk coverage potential calculation are based on external data, the institution shall be able to plausibly demonstrate that the underlying data appropriately reflect the institution’s true circumstances.’ In practice this means that institutions cannot solely rely on and use external credit ratings without critical analysis and reflection. In fact, a significant number of German LSIs in the cooperative sector use internally developed rating and portfolio credit risk quantification methodologies, which are calibrated based on a comprehensive data pool. The above-mentioned requirements apply regardless of the institution’s methods used for calculating its own funds under Pillar 1. BaFin and the Bundesbank assess the methods and procedures employed by the institutions within their ICAAPs, the underlying assumptions and the input data used in quantifying credit risk at the individual and portfolio level in on-site inspections. In this respect, credit ratings used by the institutions in their credit risk assessment are routinely reviewed.
Greece	LSIs in Greece do not apply IRB models for credit risk own funds requirements due to the nature, scale, and complexity of institutions’ processes. We do not have specific guidance in this respect; however we have the Regulation on granting permissions for using internal models, approaches and methods according to Regulation (EU) No 575/2013.
Hungary	There is no general practice in Hungary to rely on ECAI ratings, generally because a bulk part of the portfolio is unrated. There are certain segments where ECAI ratings do cover a significant part of the portfolio, these are sovereign, institutions and lately corporate bonds. ECAI coverage is mostly insignificant for all other segments (Income-producing real estate finances, SME, Micro, retail,

Member State	Answer
	municipalities). In case of sovereign, we generally apply standard risk weight in our SREP calculation and verify that there is no significant capital gain not using STA. In case of IRB banks we compare banks' own sovereign PDs with EBA benchmark PDs and apply an FIRB calculation to them. For corporate bonds we do not apply any specific add-on due to the fact that they do not have a significant share in the general corporate lending in Hungary.
Ireland	Please see Q2a
Italy	Please see Q2a
Latvia	According to the Regulation on credit risk management banks should develop a methodology of assessment of the credit risk of exposures to individual obligors, securities or securitisation positions and credit risk at the portfolio level and not rely solely or mechanistically on external credit ratings and do not use them as the only credit risk assessment criterion.
Lithuania	Lending to the private sector (corporates and private individuals) is not reliant on external ratings at all. In this case banks (apart from the IRB ones) have their internal grading methodologies (based on obligors' financial data, payment behaviour, external overdue, etc.). Only volumes of investments in bonds and corresponding accounts in credit institutions are limited based on counterparties' external ratings, however bonds are mostly EU Member States' government bonds.
Luxembourg	We have relied on Article 79(b) CRD IV, as transposed into the CSSF Regulation 15-02 (in particular Article 9(2) thereof), to perform on-site inspections to verify that banks have developed internal methodologies that enable them to assess the credit risk of exposures to individual obligors, securities or securitisation positions and credit risk at the portfolio level, without relying solely or mechanistically on external credit ratings.
Malta	It can be highlighted that until now, the MFSA did not feel the need to encourage banks to develop internal credit risk assessment capacity and increase the use of the internal ratings based approach. None of the less significant banks make use of the IRB approach. Also most banks are small and have small loan books on which it is difficult to model, there might be a lack of in-house knowledge/expertise (outsourcing is expensive) and also lack of reliable and applicable data on which to model. However, there was a particular instance whereby the Authority had asked for specific data related to their estimation of LGDs and PDs. This was carried out in order to assess whether the bank carries out an assessment of whether the Standardised Approach underestimates its credit risk.

Member State	Answer
	This was also a result of the peculiarities of the bank’s loan book, which is mainly based on trade finance. Thus, while the Authority did not push for the adoption of internal models for regulatory reporting/capital determination purposes, we have in certain cases assessed whether such internal models are used, particularly to determine whether the Standardised Approach results in an underestimate of the capital at risk for credit risk.
Netherlands	In our supervision, we monitor and challenge the internal methodologies, policies and standards, which the institutions use to assess the credit risk of exposures to individual obligors, securities or securitisation positions and credit risk at the portfolio level. We also check how credit risks are assessed in practice through our on-site review of individual credit files. If we find that institutions unduly rely on external ratings, we request the development of an internal review process to challenge these external ratings.
Poland	According to the Regulation of the Ministry of Finance of 6 March 2017 on the risk management system and internal control system, remuneration policy and detailed method of internal capital estimation in banks (Article 18): ‘While implementing the risk management strategy, the bank introduces and updates risk management policies and procedures, specifying in particular: 1) with regard to credit risk and counterparty risk: (a) internal methods for identifying, measuring or estimating the credit risk of exposures to individual obligors, securities or securitisation positions and credit risk at the portfolio level; these methods must not rely solely or mechanically on external credit assessments. If, for the purposes of calculating capital requirements, a bank uses assessments made by External Credit Assessment Institutions or the capital requirement is based on the fact that the exposure does not have such an assessment, the bank is not exempted from taking into account other relevant information when assessing the level of internal capital maintained.’ It is being monitored as a part of the SREP process, where banks have to fill in the Self-assessment Questionnaire. One of the questions in the credit risk section covers the external ratings, namely: ‘Do the bank's internal methods identify, measure or estimate the credit risk of exposures to individual obligors, securities or securitisation positions, and credit risk at the portfolio level? Are these methods based solely on external credit assessments? Please provide the solutions adopted in this regard.’ The aspects of banks' use of credit assessments (ratings) issued by External Credit Assessment Institutions are also subject to examination as a part of on-site supervision of banks for these entities for which the inspection plan includes the assessment of the

Member State	Answer
	capital adequacy. The assessment includes the compliance of banks with the applicable legal provisions. The general approach of the PFSA as to the direction of the development of methods used for the purposes of capital adequacy was presented in the Recommendation W of the PFSA on model risk management in banks. It was specified in the Recommendation that bearing in mind the content of recital 42 CRR and Article 77(1) and (3) CRD IV, the PFSA expects that, as a result of implementing the Recommendation and improving the quality of model risk management, banks will undertake activities aimed at increasing the use of internal risk methodologies also as part of the calculation of capital requirements for regulatory requirements to ensure greater consistency between the level of capital requirements and the bank's risk level.
Portugal	No specific action is envisaged to specifically address reduction of references to current external ratings provisions, though it should be noted, as mentioned, that the banking prudential framework is mainly EU-based. Taking into account those principles in RGICSF, supervisory teams assess, monitor and challenge the use of credit rating systems by the institutions as part of their ongoing monitoring responsibilities.
Romania	In Romania there is a small number of counterparties assessed by external rating agencies and the credit institutions do not rely exclusively on these ratings. Credit institutions under the NBR supervision are using their own models for assessing the credit risk exposure to individual debtors and also for assessing credit risk at the portfolio level, models which are reviewed by the supervisors in SREP.
Slovenia	As mentioned previously, Bank of Slovenia gave a clear signal to most important Slovenian significant banks to start developing an internal ratings based approach to better assess their credit risk. Since this is rather a long-term process from the perspective of data availability, data quality, resource capacity, Bank of Slovenia set out its expectations for banks already a few years ago to encourage them to start developing such internal models.
Spain	As stated before, Spanish LSIs are not sufficiently significant in terms of their size, internal organisation and the nature, scale and complexity of their activities to apply the internal ratings based approach for credit risk for prudential purposes. The Spanish regulation to assess the credit risk of exposures to individual obligors, securities or securitisation positions and credit risk at the portfolio level for accounting and risk management purposes is included in the Circular 4/2017 of the Banco de España. In this circular it is stated that the entity may use internal methodologies to estimate coverage even if it has not developed internal models to determine capital requirements.

Member State	Answer
	In addition, paragraph 93 of the Annex 9 of Circular 4/2017 requires for the classification of exposures according to their credit risk, a collective assessment at portfolio level of those risk factors that are not or could not be analysed at individual level. For these purposes, entities shall cluster the exposures in homogenous groups in terms of credit risk.
Sweden	In 2015 SFSA encouraged institutions already using the IRB approach to develop own models for exposures to central governments and central banks. The model applications that followed were finally approved in 2017.

Question 2c: Article 77(3) CRD

Please describe how you have encouraged institutions, taking into account their size, internal organisation and the nature, scale and complexity of their activities, to develop internal specific risk assessment capacity and to increase use of internal models for calculating own funds requirements for specific risk of debt instruments in the trading book, together with internal models to calculate own funds requirements for default and migration risk where their exposures to specific risk are material in absolute terms and where they have a large number of material positions in debt instruments of different issuers.

Member State	Answer
Austria	Article 79(b) CRD is transposed in the national regulation on credit institution risk management (Pillar 2) – please see Section 5 (2) KI-RMV: 'credit institutions must have in place internal methodologies that enable them to assess the credit risk of exposures to individual obligors, securities or securitisation positions and credit risk both at the portfolio level and the level of groups of connected clients. In particular, internal methodologies shall not rely solely or mechanistically on external credit ratings. Where own funds requirements are based on a rating by an External Credit Assessment Institution (ECAI) or on the fact that no rating exists for a risk position, this shall not exempt credit institutions from the obligation to additionally consider other relevant information for assessing their allocation of internal capital.' The largest institutions in AT (mostly SIs) use the IRB approach. Those institutions under our direct supervision that apply the Standardised Approach for credit risk use adequate internal models under Pillar 2 which are assessed during credit risk on-site examinations. In our experience, banks do not rely solely or mechanistically on external credit ratings. This is also verified in the course of credit risk on-site-examinations.
Belgium	We acknowledged that the development of an internal model for market risk is a large project that might require several stages/steps. Therefore, we accepted that banks developed an internal model for general risk only, as a first step. However, in that case, we expected that banks should enhance their model to cover specific risk, according to a detailed roll-out plan.
Bulgaria	For specific debt instruments, as well as default and migration risk, again by issuing an Ordinance No 7 of 24 April 2014 on Organisation and Risk Management of Banks, Article 18 (1) and (2). For the specific legal text, please refer to the answer to Question 2a).

Member State	Answer
Croatia	Article 77 (3) CRD is transposed in the Credit Institutions Act, in Article 115 (2): ‘Credit institutions that are significant in terms of their size, internal organisation and the nature, scale and complexity of their activities shall, without prejudice to the fulfilment of the criteria laid dawn in Part Three, Title IV, Chapter V, Sections 1 to 5 of Regulation (EU) no 575/2013, take appropriate measures to develop internal specific risk assessment capacity and to develop and use internal models for calculating own funds requirements for specific risk of debt instruments in the trading book, together with internal models to calculate own funds requirements for default and migration risk: a) where their exposures are material in absolute terms, and b) where they have a large number of material positions in debt instruments of different issuers.’ There are no credit institutions with such significant operations in Croatia.
Czech Republic	Trading portfolios of banks in the Czech Republic are generally limited in terms of their size, scale and complexity of their activities. In most cases trading activities are rather centralised in their parent companies. Thus, Czech banks do not have a large number of material positions in debt instruments of different issuers in their portfolios. Based on the assessments performed by banks, the development and implementation cost would exceed benefits resulting from the use of internal models for specific risk of debt instruments in the trading book.
Denmark	Given the requirements for internal models, only institutions with a suitable size and a strong internal organisation should apply internal models to calculate own funds requirements. The DK-FSA monitors the complexity of the risks stemming from such institutions’ trading books on a regular basis. Only institutions with a significant amount of complex exposures from which the risks are not expected to be captured accurately by the SA are expected to develop internal models to calculate the own funds requirements for specific risk or expand the scope of their already approved models to include specific risks. The same holds for internal models to calculate own funds requirements for default and migration risks.
Estonia	There are no such banks operating in Estonia.
Finland	No particular actions in this matter.
France	Most Significant Institutions (SI) in France have developed internal models for specific risk of debt instruments in the trading book, for default and migration risk, due to the nature, scale and complexity of their trading book.

Member State	Answer
Germany	There are no specific national measures which explicitly encourage institutions to develop internal specific risk assessment capacity of debt instruments. However, existing regulation requires institutions to have a risk management adequate to its size, complexity and business structure. The legal basis for the regulation of risk management is Section 25a (1) KWG. BaFin issued the circular on Minimum Requirements on Risk Management (MaRisk) outlining its expectations on risk management. As a circular MaRisk provide guidance on supervisory expectations for appropriate and effective risk management, on the basis of which an institution shall continuously safeguard its internal capital adequacy. MaRisk is a proportionate framework, which sets detailed requirements to expand on Section 25a KWG aimed at the management of all material risks of an institution (including also specific risk of debt instruments or default and migration risk if material for the institution). The philosophy of proportionality is important in regards to risk management standards for German banks as specified in KWG. The risk management processes and mechanisms are to be proportionate to the nature, scale, and complexity of risks inherent in the business model and the institution's activities. In practice, this means that institutions with material exposures to specific risk and material positions in debt instruments of different issuers are required to apply more sophisticated risk quantification methods. On-site examinations conducted by the Bundesbank and BaFin routinely include an assessment of the suitability of methods as part of the overall review of compliance with MaRisk. On internal models for specific risk under Pillar 1: There are no specific national measures that should explicitly motivate institutions to develop internal models to measure specific risk of debt instruments nor to develop models to measure default and migration risk. However, requirements from international regulation like EBA RTS are also applied to LSIs. The potential reduction of own funds requirements implicitly motivates institutions to implement internal models instead of using Standardised Approaches. Please note that, in general, the implementation of an internal model to measure specific risk of debt instruments or default and migration risk does not necessarily imply an increase in the usage of internal ratings (instead of external ratings).
Greece	LSIs in Greece have immaterial exposures in debt instruments in the trading book, and do not apply IRB models for that purpose.
Hungary	Institutions in Hungary generally do not have material positions in debt instruments in the trading book, where default and migration risk would be material, therefore MNB does not encourage any particular methodology change in this area.

Member State	Answer
Ireland	Irish retail banking institutions do not use internal models for determining own funds requirements for market risks. The Central Bank of Ireland is not adopting a stance of encouraging these Irish retail banks to use internal models for market risk, given the limited scope of activities in their trading books. Some Irish non-retail banks use internal models for trading book market risks including specific risk and default and migration risk and generally such banks would use these models where the scale and nature of operations warrant their use. Decisions relating to the use of internal models for specific risk and default and migration risks are made by the individual institutions according to regulation, and require regulatory approval; however the CBI does not encourage banks to use these models as there is no regulatory imperative to do so.
Italy	Please see Q2a.
Latvia	The proportion of the trading book in Latvian banks' balance sheet is insignificant, for example most banks do not calculate an own funds requirement for foreign exchange risk because it does not exceed 2% of their total own funds. Taking into account the proportionality principle, the specifics and the capacity of our banks' resources we do not consider that internal models development is necessary. But it should be noted that we have Regulation on granting permissions for using internal models, approaches and methods according to Regulation (EU) No 575/2013.
Lithuania	In the Lithuanian banking sector debt instruments held for trading comprise a negligible share of assets. Besides, the trading portfolios compositions are plain and not diverse in terms of issuers – Lithuanian government bonds compose the majority of portfolios. Taking into account the complexity of trading portfolios and materiality of risk, we consider that implementation of internal models for calculation of own funds requirements would be an ineffective and unreasonable requirement. In our opinion, applying the principle of proportionality, the Standardised Approach applied by all of our banks in general sufficiently covers position risk in trading book. Therefore, instead of the use of internal models, we encourage our institutions additionally to use stress tests when calculating own funds requirement.
Luxembourg	Article 77(3) CRD is not relevant for Less Significant Institutions in Luxembourg.
Malta	It can be highlighted that until now, the MFSA did not feel the need to encourage banks to develop internal credit risk assessment capacity and increase the use of the internal ratings based approach. None of the less significant banks make use of the IRB approach.

Member State	Answer
	Also most banks are small and have small loan books on which it is difficult to model, there might be a lack of in-house knowledge/expertise (outsourcing is expensive) and also lack of reliable and applicable data on which to model. However, there was a particular instance whereby the Authority had asked for specific data related to their estimation of LGDs and PDs. This was carried out in order to assess whether the bank carries out an assessment of whether the Standardised Approach underestimates its credit risk. This was also a result of the peculiarities of the bank's loan book, which is mainly based on trade finance. Thus, while the Authority did not push for the adoption of internal models for regulatory reporting/capital determination purposes, we have in certain cases assessed whether such internal models are used, particularly to determine whether the Standardised Approach results in an underestimate of the capital at risk for credit risk.
Netherlands	No specific actions carried out to encourage institutions, considering that institutions with a significant trading book already make use of internal models for specific risk in VaR and IRC
Portugal	No specific action is envisaged to specifically address reduction of references to current external ratings provisions, though it should be noted, as mentioned, that the banking prudential framework is mainly EU-based. Taking into account those principles in RGICSF, supervisory teams assess, monitor and challenge the use of credit rating systems by the institutions as part of their ongoing monitoring responsibilities.
Romania	There are a few banks holding significant trading book portfolios (the larger ones in the system), and the large part of this portfolio is represented by Romanian government bonds (the main purpose is liquidity management).
Slovenia	Many Slovenian corporates are small in their size without any proper external credit rating. Slovenia also does not have any important credit rating agency, which would issue comprehensive credit ratings for the companies. Therefore, Bank of Slovenia insisted significant banks start to develop their own internal credit models, which would give reliable results to better assess the credit ratings of their clients.
Spain	The trading book of the Spanish LSIs is negligible, so the use of external ratings is not relevant.
Sweden	As part of our supervision of banks SFSA has an ongoing risk dialogue with bank representatives. The dialogue is based on risk sensitivity and SFSA puts emphasis on proper internal (both regulatory and non-regulatory) risk measurement and metrics and the potential necessity to make amendments to the regulatory model framework. One such area of banks' traded market risk that SFSA follows

Member State	Answer
	closely is the risk development and risk aspects connected to specific risk of debt instruments. It should be mentioned, however, that the prolonged time line with regards to the finalisation and implementation of the FRTB standards complicates matters somewhat. SFSA is aware that the implementation of the new standards within banks is challenging and resource demanding, and so in some cases there may be conflicting objectives between improving current regulatory models and implementing the (hopefully better) models under the FRTB.

Question 2d: Article 79(b) CRD

Please describe how you have encouraged institutions whose own funds requirements are based on a rating by an ECAI or based on the fact that an exposure is unrated, to additionally consider other relevant information for assessing their allocation of internal capital.

Member State	Answer
Austria	We transposed Article 79(b) CRD in our national regulation on credit institution risk management (Pillar 2) – see Section 5 (2) KI-RMV: ‘credit institutions must have in place internal methodologies that enable them to assess the credit risk of exposures to individual obligors, securities or securitisation positions and credit risk both at the portfolio level and the level of groups of connected clients. In particular, internal methodologies shall not rely solely or mechanistically on external credit ratings. Where own funds requirements are based on a rating by an External Credit Assessment Institution (ECAI) or on the fact that no rating exists for a risk position, this shall not exempt credit institutions from the obligation to additionally consider other relevant information for assessing their allocation of internal capital.’ The largest institutions in AT (mostly SIs) use the IRB approach. Those institutions under our direct supervision that apply the Standardised Approach for credit risk use adequate internal models under Pillar 2 which are assessed during credit risk on-site examinations. In our experience, banks do not rely solely or mechanistically on external credit ratings. This is also verified in the course of credit risk on-site examinations.
Belgium	We implemented the CRR regarding the use of external ratings under the Standardised Approach.
Bulgaria	Ordinance No 7 of 24 April 2014 on Organisation and Risk Management of Banks, Article 7 (5). For the specific legal text, please refer to the answer to Question 2b). Furthermore the proper in-house ICAAP analysis as well as the IFRS 9 implementation require banks to consider all relevant information for the mentioned risks and to develop their own internal models. Even if most of these models are not for regulatory purposes (not IRB compliant), they allow banks to ride away from the mechanistic reliance on the ECAI assessments when comparing their business activities to the defined risk parameters in their risk policy and risk appetite.

Member State	Answer
Croatia	Please see Q2b.
Czech Republic	In any case the rules mentioned above in 2b) apply.
Denmark	It is not deemed necessary to carry out specific undertakings considering the portfolio characteristics of Danish credit institutions and existing practices for risk classification of exposures.
Estonia	As stated before Estonian banks are not relying on external credit ratings. Banks under Finantsinspektsioon supervision are relatively small with simple business models. At the moment all of them are calculating their own funds requirements according to the Standardised Approach for credit risk.
Finland	No particular actions in this matter.
France	Please see Q2a and Q2b
Germany	German institutions – not only those whose own funds requirements are based on a rating by an ECAI or based on the fact that an exposure is unrated – are required, according to the Minimum Requirements on Risk Management (MaRisk), to additionally consider other relevant information for assessing their allocation of internal capital. Section 25a (1) KWG is the legal basis for the regulation of risk management (including credit risk) and BaFin has expanded upon the requirements of Section 25a KWG in the Minimum Requirements on Risk Management (MaRisk). As a circular MaRisk provide guidance on supervisory expectations for appropriate and effective risk management, on the basis of which an institution shall continuously safeguard its internal capital adequacy. The MaRisk is a proportionate framework, which sets detailed requirements and also outlines BaFin's expectation on credit risk management. With regard to the methods used in the institutions' internal capital adequacy assessment process, MaRisk states more precisely that: 'Parameters determined on the basis of external data and assumptions taken over uncritically from other sources shall not be used in … the determination of risk or the aggregation of risk. … If the assumptions regarding parameters of the risk calculation or risk coverage potential calculation are based on external data, the institution shall be able to plausibly demonstrate that the underlying data appropriately reflect the institution's true circumstances.'

Member State	Answer
	Furthermore, MaRisk lays down requirements relating to credit business processes. With regard to the usage of external credit assessments it is explicitly stated that: 'The use of external credit assessments shall not relieve the institution of its obligation to form its own opinion on counterparty and credit risk and to factor its own knowledge and information into the credit decision.' These requirements apply regardless of the institution's methods used for calculating its own funds under Pillar 1. BaFin and the Bundesbank determine compliance with MaRisk through a combination of on-site reviews, off-site analysis, external audit reports and thematic reviews. The scope of on-site reviews on ICAAP covers the methods and procedures employed by the institutions within their ICAAPs, the underlying assumptions and the input data used in quantifying the risk. In this respect, ratings used by the institutions as well as assumptions regarding unrated exposures are routinely reviewed.
Greece	Article 79 (b) CRD is transposed in our national regulation: 'Institutions have internal methodologies that enable them to assess the credit risk of exposures to individual obligors, securities or securitisation positions and credit risk at the portfolio level. In particular, internal methodologies shall not rely solely or mechanistically on external credit ratings. Where own funds requirements are based on a rating by an External Credit Assessment Institution (ECAI) or based on the fact that an exposure is unrated, this shall not exempt institutions from additionally considering other relevant information for assessing their allocation of internal capital'.
Hungary	MNB encourages Banks to apply more sophisticated methods mostly in Pillar 2. For large banks, the application of IRB methodology is required in Pillar 2.
Ireland	Please see Q2a
Italy	Institutions are required by Circular 285 of the Bank of Italy, in accordance with the proportionality principle, to define their own process to assess their internal capital adequacy. To this end, banks shall develop internal methodologies for the purposes of the calculation of the internal capital for credit (included concentration risk), counterparty, market, operational and any relevant risk in the context of the ICAAP process. More specifically, banks which apply the Standardised Approach for the calculation of Pillar 1 own funds requirements are allowed to use such an approach for the calculation of their internal capital. However they can also develop internal methodologies to assess the risk and determine their internal capital; this also taking into account their complexity and the possibility to apply for such model to be authorised for the calculation of Pillar 1 requirements.

Member State	Answer
	The internal capital related to single name concentration risk and IRRBB risk can be estimated (essentially by smaller institutions) referring to the methodology described in the above-mentioned Circular 285; however, banks can also develop internal methodologies to assess all the risks. Please also see Q1.
Latvia	As mentioned above, the Regulation on credit risk management includes requirement not to rely on the ratings of the ECAIs only. According to the Regulation institutions shall apply analytical methods that are appropriate to the nature and complexity of their activities when carrying out credit risk measurement, assessment and monitoring.
Lithuania	As mentioned in the answer to Question 1, there are not any specific regulations regarding ECAI, but under the ICAAP process 'the bank must have in place an effective credit risk management system encompassing the credit risk management strategy, credit risk management and assessment policy, acceptable credit risk limits, credit risk mitigation measures, other measures, procedures and processes of this risk management.' The efficiency of how the risk is managed is evaluated during the SREP and additional capital requirements may be established if necessary.
Luxembourg	We have relied on Article 79(b) CRD IV, as transposed into the CSSF Regulation 15-02 (in particular Article 18(2) thereof), to perform on-site inspections to verify that banks use additional information in their credit assessments or broaden the coverage of their internal rating systems.
Malta	It can be highlighted that until now, the MFSA did not feel the need to encourage banks to develop internal credit risk assessment capacity and increase the use of the internal ratings based approach. None of the less significant banks make use of the IRB approach. Also most banks are small and have small loan books on which it is difficult to model, there might be a lack of in-house knowledge/expertise (outsourcing is expensive) and also lack of reliable and applicable data on which to model. However, there was a particular instance whereby the Authority had asked for specific data related to their estimation of LGDs and PDs. This was carried out in order to assess whether the bank carries out an assessment of whether the Standardised Approach underestimates its credit risk. This was also a result of the peculiarities of the bank's loan book, which is mainly based on trade finance. Thus, while the Authority did not push for the adoption of internal models for regulatory reporting/capital determination purposes, we have in certain cases assessed whether such internal models are used, particularly to determine whether the Standardised Approach results in an underestimate of the capital at risk for credit risk.

Member State	Answer
Netherlands	In our supervision, we monitor and challenge the internal methodologies, policies and standards which institutions use to assess their allocation of internal capital. This includes the monitoring and challenging of the sources of information used in order to assess the allocation of capital for institutions whose own funds requirements are based on a rating by an ECAI or based on the fact that an exposure is unrated.
Portugal	No specific action is envisaged to specifically address reduction of references to current external ratings provisions, though it should be noted, as mentioned, that the banking prudential framework is mainly EU-based. Taking into account those principles in RGICSF, supervisory teams assess, monitor and challenge the use of credit rating systems by the institutions as part of their ongoing monitoring responsibilities.
Romania	As we mentioned already, credit institutions in Romania do not rely on ratings issued by ECAIs and they are using their own models for assessing the quality of debtors and for ICAAP.
Slovenia	Some banks were heavily relying just on external credit rating providers to assess the credit risk in certain portfolios (such as cross-border financing). The banks were just translating the external credit rating into an internal rating without any additional risk assessment. However, Bank of Slovenia insisted that internal risk assessment should be performed and the external credit rating should be challenged.
Spain	Please see Q2a.
Sweden	SFSA has not encouraged institutions in other ways than encouraging them at all times to follow the current capital adequacy regulations.

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