



**Committee of European  
Banking Supervisors**

Brussels, October 28, 2005  
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**CP10@c-ebs.org**

**Consultation Paper 10 :  
Guidelines on the Implementation, Validation and Assessment of Advanced  
Measurement (AMA) and Internal Ratings Based (IRB) Approaches**

Ladies, Gentlemen

The European Association of Cooperative Banks (EACB)<sup>1</sup> welcomes the CEBS's initiative to discuss its approach on the validation and assessment of the risk management and risk measurement systems.

The EACB gladly takes the opportunity to comment bring forward the views of its members on these important issues.

Yours sincerely

Hervé Guider  
Secretary General

Volker Heegemann  
Senior Advisor

<sup>1</sup> The European Association of Co-operative Banks represents over 4.500 co-operative credit institutions active in all the EU Member states and serving over 100 Million customers. Its member organisations are decentralised national networks of small-sized Co-operative banks' networks, which have a strong presence on a local or regional level. They account for a large part of the SME and private household credit market (17%) and thus play a crucial role within the Internal Market.



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## General Comments

1. The EACB supports CEBS' objective to provide guidance on the meaning and the implementation of the minimum requirements for using the advanced measurement (AMA) and internal ratings based (IRB) approaches, as set out in the Capital Requirements Directive (CRD).
2. Certainly, CP 10 provides substantially improved transparency on supervisors' objectives, concerns, expectations and approaches to advanced models issues. The avoidance of duplication and inconsistency is essential to effective implementation of CRD
3. The intention of CEBS should be to give additional 'guidance' as a basis for discussion with supervisors. The document *should not* be defined as additional law or requirements. It should serve as an example of the spirit and intentions of CEBS concerning IRB and AMA, which implies that banks could always choose for other solutions within the lines of the CRD as long as they are clearly argued.
4. Accordingly, CP10 could be beneficial, if it would stimulate open and flexible dialogue, provide clarity of expectations and procedures among supervisors; and provide recognition of the *legitimacy of variation* in banks' approaches, subject to appropriately rigorous supervisory review of the outputs of bank-developed structures, models, policies and procedures.
5. However, we are concerned that the proposed guidelines will not meet this objective to the necessary extent and that they will substantially increase the regulatory burden for banks, rather than reduce inconsistencies.
6. We would request CEBS to carefully consider the link between the present consultation paper and CP 03 on the application of the Supervisory Review Process under Pillar II. Validation is an ongoing process and should be understood as a part of the second pillar of the Basel II rules. Having said this, we believe that there are relevant contradictions between CP 10 and CP 03.
7. CEBS seems to adopt too great a level of detail, without necessarily creating increased clarity. CEBS runs the risk that the proposed guidance could cloud the understanding of concepts already established in prior negotiations. CEBS should adopt a top-down, principles-based approach which deals with only the most important issues in line with the proposals that are made in CP 03. This would also solve the problem of the inconsistencies and the lack of structure which we believe have been built into CP 10.
8. Furthermore, we doubt that such level of detail is required for the creation of an integrated financial market: accordingly, CEBS should aim to develop a set of minimum standards in areas that are sensitive in terms of competition and are necessary for a level playing-field. Accordingly, there should remain a margin of discretion for national authorities in certain areas.
9. In the opinion of the members of the EACB the feeling prevails that this document, in parts leads to highly detailed maximum standards, which partly include excessive conservatism. This makes the proposed provisions particularly burdensome as



regards how a bank must structure its internal governance. If CEBS' guidelines were to be implemented strictly, the shape of banks' businesses would in effect be dictated by legislation and guidance which could stymie an institution's ability to organise itself to carry out its day-to-day business and best serve its customers. We believe that the standards set in the paper are excessively intrusive and interfere too largely with the responsibilities of both the supervisory and management functions.

10. The high level of detail and conservatism on a number of issues will create problems in particular for smaller banks, which will have to bear a comparatively higher cost burden than bigger banks. In this respect it has to be considered that a very important number of banks in the EU is operating in one member-state only. However, detailed guidelines on issues such as PD are highly desirable, if they are to avoid diverging approaches of home and host supervisors.
11. Furthermore, some go beyond the scope of the CRD. We believe that CEBS' guidelines should merely serve CEBS' self-defined objective of laying down a common understanding of the CRD requirements. We would, therefore, urge CEBS to set out mandatory minimum standards with parameters of acceptable divergence built into them, rather than to seek maximum harmonisation. To this aim, there is an urgent need for CEBS to strike a better balance between the different supervisory cultures within its membership.
12. In general, and in particular with a view to smaller institutions that have adopted the more advanced approaches, we would request CEBS to ensure that the principles of proportionality and flexibility be maintained and applied appropriately. This should be enhanced through an extensive dialogue between supervisors and the institution, which we believe is largely neglected in the proposed consultation paper.
13. We call on CEBS to clarify that in its function as a guidance paper CP 10 provides recommendations rather than imperative instructions. We find the tone of the paper misleading in this regard and would urge CEBS to reconsider in particular its use of modal verbs ("could" rather than "should").
14. We welcome CEBS' aim of promoting convergence of supervisory approaches across the EU member states. However, we believe that the proposed application form will not work as a vehicle for the exchange of information between supervisors given the extensive level of detail which constitutes an unmanageable quantity of information. In order to streamline the common supervisory requirements we would suggest the adoption of a qualification certificate which would provide a list of the main qualification points. It would be used by the consolidating supervisor for its compliance assessment and serve as a communication tool between supervisors. At the same time, it should be the basis for information requests from other supervisors to the consolidating supervisor for group matters, whereas information requests on local issues would be addressed directly to the bank.
15. The EACB has serious concerns in terms of timing. Supervisors are in many cases already well-advanced in their preparations for the use of the new capital requirements rules and have launched many advanced examinations and application packs. Banks have adjusted their internal structures to these prior supervisory guidelines. The provisions laid down are often not in line or substantially stricter than the current implementation regimes. It would result in a serious duplication of work and major administrative costs if banks were at this stage to comply with the additional pack of guidelines laid down in CP 10, especially given the fact that there is



no possibility for banks to backtrack to prior stages in the implementation process. We would therefore strongly recommend that the revised version of CP 10 be understood as a long-term goal, rather than as guidance for the initial validation process. In the context of CP10 being a long term aim and a learning process for supervisors and institutions alike, the EACB would also urge supervisors to show flexibility, particularly in the beginning of CRD application. Certain, reasonable breaches of supervisors' expectations may occur in the early phases and should be tolerated if an institution clearly demonstrates its willingness to improve and to cooperate.

## **Specific Comments**

### **Proportionality**

Neither size, importance, business volume of credit institutions, nor the decentralized structures of certain networks seems to be reflected to a sufficient degree. Explanatory notes on these issues would be desirable, especially on the outsourcing of systems to central institutions, as well as the examination and approval of such systems.

### **Paragraph 1.3. Addresses / Scope of Application**

Supervisors are to treat an institution which has opted to apply an AMA or IRB approach as a "sophisticated institution" (no.21). We seriously doubt that such classification is appropriate. There are good reasons why small and medium-sized banks may also decide to use an internal rating system without applying particularly risk-sensitive methods of measuring and managing risk in all other areas. For this reason, the Basel Committee dropped its original intention, as set out in the first consultation paper on Basel II, of admitting only "highly sophisticated" institutions to the use of internal rating systems. If the current wording is retained, many institutions would be prevented from using a more advanced approach. This would be at odds with the objectives of both Basel II and European legislators. To the contrary, there should be incentives for smaller, non sophisticated banks, to apply the IRB approach. We therefore suggest to delete the last sentence no. 21 to be deleted.

### **Paragraph 3.3.3 Rating Systems and Risk Quantification**

Regarding the description of requirements for the rating systems, CEBS predominantly focuses on statistical systems and mentions expert systems only briefly at the low-default segment. This is, however, does not fully reflect reality. Expert systems are frequently used in segments with high number of customers and have certain advantages. Expert systems are also applied e.g. at segments of commercial customers, and they are not necessarily considered as "introductory (basic) systems", which operate until a statistical system is put in place.

Expert systems are not sufficiently referenced in other parts of the document as well. We miss guidelines e.g. on their validation, which would be a basis for orientation for both regulatory authorities and banks.



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### **Paragraph 3.3.3.1 Probability of Default - PD Estimation Methodology and Paragraph 3.5.3 Low-Default Portfolios**

The *Paper* merely mentions disclosure criteria. There is no indication regarding the procedures allowed for the determination of PDs. Detailed guidelines on these issues would be desirable as guidance for both regulatory authorities and banks, otherwise regulatory authorities responsible for the approval of methodologies might base their decisions based on more subjective criteria.

Such procedures for the determination of PDs should be indicated in the case of low-default portfolios. In our opinion it is not sufficient to refer to “*adequate margins of conservatism*” (par. 349) only or to the requirements of “*use test*” (par. 351). In case the appropriate calculation and assessment methods are not indicated, there is a danger for credit institutions, which operate in more than one Member State, that one method is approved in one country but in another one it is not accepted (this problem has not been addressed in the home-host supervisor discussions either).

### **Par. 53 - Documentation of Rating Systems**

This paragraph requires banks to provide all internal documentation to the supervisory authorities during the certification procedures of a rating system. This clause should be amended so that only documents that are definitely necessary for a proper judgement on the approval of the rating system need to be provided to the authorities.