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CEBS consultation paper "Guidelines on the implementation, validation and assessment of Advanced Measurement (AMA) and Internal Ratings Based (IRB) Approaches" CP10

Dear Mr. Roldán,

The Zentraler Kreditausschuss is grateful for the opportunity to comment on CEBS's "Guidelines on the implementation, validation and assessment of Advanced Measurement (AMA) and Internal Ratings Based (IRB) Approaches".

General remarks

We welcome CEBS's objective of promoting a common understanding of the minimum requirements for the IRBA and AMA among European supervisory authorities in order to facilitate the use of the cooperation procedures under Article 129 (2) of the CRD and bring about a consistent application of rules and a convergence of supervisory practices in the EU. In our view, however, the guidelines fail to carry out this intention in an appropriate manner.

When drawing up the guidelines, it should first be borne in mind that a basic principle in creating a single market is to achieve minimum harmonisation in areas of particular relevance to competition. This reflects the principle of subsidiarity and must not be turned into its opposite – namely detailed maximum harmonisation – by regulatory requirements set by CEBS focussing on convergence. National supervisory authorities must continue to have sufficient discretion on matters of detail so that account may be taken of national specificities when transposing European directives. As was pointed out in the European Commission's recent green paper on financial services policy, the focus should shift in future to implementing existing European legislation in national law, assessing its impact and, if necessary, consolidating it. Such legislative breathing spaces should not be undermined by simultaneously stepping-up of administrative regulation.

The consistent application of directives and the convergence of supervisory practices in the EU should not lead to a high level of detail and a disproportionately costly additional administrative burden for financial institutions, particularly small banks. This applies all the more in view of the fact that the majority of European banks operate only at national level.

It should, above all, be ensured that the guidelines do not give rise to rules going beyond what is required under the CRD since the Lamfalussy process gives CEBS no mandate to call into question, let alone modify, democratically legitimated decisions. This applies particularly to areas where European legislators have consciously and for good reasons not adopted some of the Basel framework's more restrictive requirements so that solutions can be implemented in the banks which reflect market realities.

In their present form, the guidelines contain a high degree of detail – in some cases without offering additional clarification. They risk becoming a further level of regulation whose scope is unclear, limiting or replacing understandings already arrived at during the consultation process (Basel II, CRD, national implementation expert groups). Limiting the guidelines to major issues that are relevant to ensuring a level playing field would allow lean documentation. The proposals should therefore be understood merely as guidelines for implementation.

It would also be appropriate for CEBS to refrain from specifying excessively detailed rules in view of the fact that extensive groundwork has already been laid at national level concerning the form of approval processes and the interpretation of minimum requirements. Should the guidelines contain a high level of detail, this will increase the danger of inconsistencies with adjustments which have already been carried out to comply with guidelines issued by national specialist bodies. This would give rise to considerable additional costs for the banks. The consultation paper, which in its present

form will have significant implications for implementation, was prepared at a very late and thus unfortunate stage, in our view. This is particularly critical in view of the preparation of a second paper, which is to be released for consultation only at the beginning of next year. This second paper is to discuss issues which are not easy to solve from a methodological point of view and for which the banks have as a rule already found their own solutions or which the banks have already discussed with their national competent authorities. We therefore also reject additional, highly detailed rules issued in the course of a further round of consultations.

To establish a level playing field, it is necessary only to set targets that should be met within the approval process, not detailed steps that might not be appropriate. Supervisors should allow financial institutions to develop best practice and should only define minimum standards. This is not always the case in the present guidelines, as there is, for example, no distinction between "nice to have" and "mandatory requirement".

The proposed procedures
- are often highly conservative,
- add requirements going beyond the CRD (e.g. nos. 64, 225 and 429),
- are sometimes not in line with common modelling techniques,
contain impractical restrictions on the banks' internal governance (excessive involvement of senior management required in sections 3.6 and 4.3.5).

Sections 3.6 and 4.3.5 on internal governance impose specific, prescriptive obligations on banks' supervisory bodies and senior management in relation to credit and operational risk which go significantly beyond the text of the CRD, in our view. These prescriptive requirements could mean, for example, that institutions will need to substantially modify board level/senior management committee terms of reference and spend valuable board and senior management time on issues which could be successfully dealt with either by delegation or at a lower organisational level. We therefore recommend that CEBS drop the prescriptive requirements for banks' (institutions') corporate governance bodies and senior management. Instead, we suggest that CEBS should provide only high-level guidance.

Finally according to no. 23 Supervisors are only allowed to impose more stringent or more detailed requirements. As CP 10 is not legally binding, we strongly disagree with the implied status of the paper as yet another set of minimum requirements. In our view, CP 10 can, on the contrary, only provide guidelines and examples to support the consistent application of the framework in the EU.

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The following remarks are based on the understanding that, as mentioned above, the contents of CP 10 are not to be interpreted as minimum requirements but rather as a collection of useful and illustrative guidelines and examples for the implementation, validation and assessment of IRB and AMA approaches. Thus, these remarks are by no means exhaustive but will illustrate by means of examples the German banking industry's views on these issues.

Chapter 1: Introduction

No. 21
Supervisors are to view an institution which has opted to apply an AMA or IRB approach as a "sophisticated institution". We reject such a classification. There are good reasons why small and medium-sized banks may also decide to use an internal rating system without their 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 permitting internal rating systems only for "highly sophisticated" institutions. If this 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. We therefore ask for the last sentence of no. 21 to be deleted.

Chapter 2: Cooperation procedures, approval and post approval process

When specifying the criteria for an application for IRBA approval, it is important, as a general principle, to ensure that the banks are required to provide only information which is relevant to assessing the application. The requirements should also be neutral with respect to the way in which the information is presented – i.e. the decisive point should be that the information is made available to supervisors. Rules on how the information is presented should be avoided as far as possible. This applies particularly when this would entail presenting it in a format other that that already used by institutions when applying for IRBA approval at national level.

In general, we support the views set out in this chapter and particularly welcome the strong position of the home supervisor reflected in nos. 39 and 81.

We would like to draw your attention to the following detailed remarks:

No. 38

The introduction of a pre-application phase raises first and foremost the question of how much work this will entail for the banks. The text refers to this problem only in passing, however. We believe it would be helpful to spell out more clearly the expected role of the banks during this phase.

No. 49

The cover letter should state that the members of the group are applying jointly for the permissions referred to in the relevant articles of the directive. Since permission to use internal ratings systems is given on the basis of national rules, the application should also refer to the relevant provisions in the member state of the consolidating supervisor.

No. 64

On the issue of self-assessment, guidelines are given on who should be responsible for implementation. We do not see the need for any guidelines on this issue. Since these are internal assessments by the banks themselves, it should also be possible to decide internally who should conduct the assessing. We therefore suggest deleting these proposals.

Chapter 3: Supervisor's assessment of the application concerning the minimum requirements of the CRD-Credit Risk

We would like to draw your attention to the following detailed remarks:

Nos. 108-109

Strategic decisions that may require an alteration of the roll-out plan should not be limited to the reasons mentioned in nos. 108 and 109. Institutions must be free to decide how to allocate their resources.

Nos. 113-114

As exemptions are already subject to supervisory assessment, the bureaucratic burden of the required justification should be reduced. Cherry picking is already prevented by setting (low) thresholds and by the required supervisory approval. The general reasons are sufficiently described.

Nos. 125-145
The rules on the use test are unclear and sometimes contradictory. This applies particularly to the possibility of using different IRBA risk parameters internally to those used for regulatory purposes. The rule in Annex VII, Part 4, paragraph 55 of the CRD, which clarifies that differences must be documented and the adequacy of the assessments demonstrated to supervisors is perfectly sufficient, in our view. The statements in the consultation paper going beyond this do nothing to clarify this provision and should therefore be deleted.

Irrespective of this, the following points should be borne in mind:

No. 129
It should be clarified that the assessment of differences is not an ongoing procedure, but only part of the approval process.

No. 133
It should be clarified that the assessment of differences between internal and supervisory purposes is not an ongoing procedure, but only part of the approval process.

No. 141
The requirement for mandatory use in the corporate exposure class of risk factors which can be derived from the financial statements should be dropped. It is true that Annex VII, Part 4, paragraph 19 of the CRD requires all relevant and material information to be used when assigning ratings. Nevertheless, this requirement can only refer to information which is available to the bank. If the bank has no information available from financial statements and is not legally required to obtain it, it must be possible to assign a rating without using this risk data.

No. 148
The reference to risk measurement and management is unspecific. Any topic might be covered by that (see also Article 84(2b)). The requirements are subsequently repeated e.g. in the sections on data and internal governance. There is no consistency between requirements.

No. 153
CEBS envisages that it should generally be assumed that a borrower is an SME if it is "separately incorporated". It should be clarified that "separately incorporated" does not cover sole proprietors, self-employed persons, tradesmen and partnerships of sole proprietors. Nor should these be

excluded from being treated as an individual person by the criteria that "the majority of his or her income is generated by the self-employed occupation".

No. 154
The majority of supervisory authorities advocate applying the risk weight function for corporate exposures even if the one million euro threshold is exceeded only temporarily and the violation is immaterial. In our view, it should be permissible to continue applying the risk weight curve for retail exposures in such cases since the risk associated with the exposure does not (significantly) change when the threshold is exceeded and the time limit rules out the possibility of abuse.

No 156
The consultation paper envisages that: "If exposures cannot be aggregated automatically, institutions **should at least ask their clients** about the size of other exposures in order to determine whether the total exposure exceeds the EUR 1 million threshold." This requirement does not reflect market realities and should therefore be deleted.

No. 162
It is not true that "a significant number of exposures" implies that the number is large enough to generate reliable estimates of parameters; see, for example, "low default portfolios". This requirement should be dropped.

No. 168
The requirement to measure loss volatility for all three retail classes and exposures types imposes an unacceptable burden. This requirement furthermore goes beyond the CRD and should therefore be deleted.

No. 176
In many cases an SL borrower will not be an SPV, e.g. housing associations. This requirement should be dropped.

No. 193
Institutions are required to take into account indications of unlikeliness to pay other than those set out in the CRD. This is to be rejected. Tracking a set of additional indications of default would be extremely onerous and could result in competitive distortions. Furthermore, this goes beyond what is required by the CRD.

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Nos. 198-199
The definitions of realised loss and loss in LGD are unclear and potentially ambiguous.

No 202
The discussion concerning which discount rate must be used in order to determine economic loss is another good illustration of the fact that the level of detail in CP 10 exceeds pragmatic regulation. Banks themselves have a keen interest in accurately estimating the loss given default. It should therefore be left to the banks' judgment how best to take into account that certain outstanding amounts are paid at a future date. As further assumptions are needed to calculate the contribution of future cash flows to the loss given default (e.g. date of cash flow, recovery amounts) there will be estimate errors. Prescribing how to determine the appropriate discount rate thus only appears to enhance precision.

Nos. 215 ff.
The requirements for LGD estimation will lead to two different processes: one for internal use and a second for supervisory use (e.g. downturn LGD). This is impractical.

No. 218
The requirement does not match with the important questions of calibration and validation of LGD parameters. A statistical estimator cannot fit with the requirement to estimate downturn LGD if there is not a permanent economic downturn period.

No. 225
This is not part of the CRD framework and should be dropped.

Nos. 231-232
It is not clear how institutions should incorporate incomplete workout information: as part of their cash-flow estimates or as part of the collateral basis? In particular, the requirement makes no sense for workouts with binary payments, e.g. the liquidation of mortgage loans.

No. 233
"If institutions are using recovery rates not higher than the already collected recoveries, then the estimated LGD will be based on a measure of average realised LGDs." This requirement is unclear.

No. 236
"Current market prices of collateral on current exposures will influence their estimated LGD." This is not the case if a liquidation value approach is followed, which is common in many institutions.

No. 237
"Use of market prices for defaulted exposures for LGD estimation in case of scarce internal loss data" enforces the use of probably unrelated information. This is unacceptable. The use of market data may be useful in some cases and inappropriate in others.

Nos. 245 ff.
The guidelines should be adapted to the wording of the CRD for CF. EAD modelling is very restrictive by using CF on the undrawn amount – a common but very questionable modelling approach which is not suitable for aval lines, for example.

No. 247
The "momentum approach" (to calibrating CF) is mentioned here but only defined later in no. 253.

No. 277
The text appears to refer only to PD ratings and is not appropriate as a requirement for LGD/CF calibrations/modelling. No. 276 states that section 3.3.4 applies to all kinds of model development and validation, including PD, LGD, and CF estimation.

No. 308-309
These guidelines are too prescriptive to be practical. The particular approach to (and minimum requirements for documentation of) verifying systems compliance should be left to the discretion of individual regulators in the context of existing national guidelines.

No. 312
Representativeness and/or comparability analyses require all key characteristics to be similar. Suggested criteria include distribution of the population according to key characteristics and the level and range of these key characteristics. This is impractical as not every single driver can be representative in a development or test sample.

No. 323
The credit risk parameters mentioned in the guidelines are "PD, LGD and CF". This is ambiguous since a CF could mean either an estimate of a future exposure at default or the empirical parameter

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expressing historical drivers of EAD. If the latter is meant, it must be pointed that out that one parameter is insufficient for observing the drivers of EAD. In reality, two drivers (two primary credit risk parameters) exist: empirical EADs are determined by
a) the propensity of obligors to use open credit lines prior to default (so-called "K-factor") and b) the empirical behaviour of conversions from non-cash EADs into cash-equivalent EADs in the case of non-cash products (so-called "CEEFW"). Since these drivers do not act in parallel, they should be incorporated into the EAD methodology separately.

Nos. 324 ff.
The distinction in Principle 1 between risk estimates and ratings is unclear.

No. 325
The guidelines require the verification of rating systems to be characterised by an appropriate level of objectivity, accuracy, stability and conservatism. This requirement of objectivity/accuracy, however, cannot be met using a conservative estimate.

No. 329
Historical data must be the basis for the calibration of credit risk parameters. Adjustments may be necessary in order to make sure that the parameters are forward-looking. The guideline does not, however, define situations in which adjustments are required and explain how to quantify the adjustments. It does not define how a bank can prove that deviations from historical experience are appropriate. Furthermore, the guideline does not define how banks can demonstrate that their estimates are representative of likely long-term rates. Clarification would be helpful.

No. 333
A validation concept that includes the assessment of qualitative factors is excessive as this is part of the use-test and self-assessment. The rating system is again focused very much on the rating tool itself, not the extensive interpretation of all IT systems and processes that are used (probably leading to a too extensive interpretation).The requirement to use the rating system as a core element in the risk management system already requires ("common sense") an institution to assess qualitative factors. How this issue is addressed does not need to be specified (except the guiding principle to validate the system).

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No. 337
"In cases where lack of internal or external data prevents the proper use of [benchmarking and/or backtesting], institutions should apply a higher margin of conservatism in their estimations." It is unclear what "higher margin" means and how it should be measured.

No. 352
"Limitations owing to the dataset should not exempt institutions from performing a quantitative validation on low-default portfolios". This is a contradiction in terms as a lack of data will not allow useful quantitative validation. The requirement is thus impracticable.

Nos. 360-364
This is an unnecessary discussion with regard to Annex VII, Part 4, paragraph 127 of the CRD. Details of the organisational set-up should be up to institutions. The statement in no. 364 that the "coexistence of both functions (model development and model review) in the same unit should not be seen as an obstacle" is sufficient.

Chapter 4: Supervisor's assessment of the application concerning the minimum requirements of the CRD – Operational Risk

We expected the guidelines on the implementation, validation and assessment of the advanced measurement approach to offer further guidance based on the European Capital Requirements Directive. However, as pointed out above, the document contains some very detailed requirements going beyond the those of the CRD. Even the relationship between the requirements in the CRD and those in the guidelines is not always clear.

We would also appreciate clarification that the examples provided are to be understood only as possible, not as exhaustive, lists. Banks should have the option of using solutions which are different from those mentioned.

We would like to draw your attention to the following specific remarks:

No. 418
Table 2 indicates the partial use combinations in conjunction with a "solo capital requirement". In almost all cases the combinations are deemed unacceptable. During discussions, however, it was indicated that a temporary partial would be possible as long as the bigger part of the legal entity was covered by AMA and the AMA roll-out plan indicated the completion of AMA

implementation to a predefined degree within a certain period of time. During the transition period, the AMA capital would be part of the bank's overall capital.

We would therefore appreciate clarification of whether no. 418 refers to permanent partial use or temporary partial use pursuant to no. 428. We should like to stress that Table 2's requirements represent an inappropriate restriction for the transition during the roll-out.

No. 422

According to no. 422, use of the ASA requires pre-authorisation from the competent authorities in addition to normal approval. It is not clear what this requirement is intended to achieve. Furthermore, it exceeds what is required by the directive and thus CEBS' mandate (interpretation of the directive). It should therefore be deleted.

No. 425

According to no. 425, ASA institutions must have documented systems in place to demonstrate to the competent authorities that they hold a risky loan portfolio and charge high interest rate margins. The CRD merely requires banks to demonstrate that the ASA offers the better basis for assessing operational risk (Annex 2, Part 2, paragraph 16). It should be left to the banks to decide what form the evidence required by the CRD will take. CEBS' specification should therefore be deleted.

No 429

According to Annex X, Part 4, paragraph 2 of the CRD, the competent authorities may, in *certain isolated cases,* impose additional requirements concerning partial use of an AMA (minimum cover at the beginning of implementation and commitment to a complete roll-out). In no. 429, CEBS states that supervisory authorities are expected to apply these additional conditions *in most cases*. The CRD consciously envisages that permanent partial use will be the norm, also of material units. The CEBS proposal thus undermines the objective of the directive, is not covered by CEBS' mandate and should be deleted.[1]

"Regardless of the methods used by competent authorities, all business lines and operations should be captured by one of the operational risk methodologies." This does not adequately reflect the principle of materiality, in our view.

[1] The following proposals in section 4.3 are consequently assessed subject to the fundamental request that "minimum cover" and "roll-out plan" will, as envisaged by the directive, only be necessary in exceptional cases.

Some non-material areas of the bank would be implicitly covered by the methodology applied to the group. The sentence suggests that, even for these areas, the operational risk methodology has to be explicitly applied. We would therefore suggest the alternative wording: "..., all material business lines and operations should be captured ...".

In addition, we would welcome clarification of whether prudentially prescribed business lines are meant here or whether a bank's own internal definition may be applied.

No. 430
The recommendation to start the roll-out plan with "the riskier of the remaining operations" should be dropped. The sequence of the roll-out plan is based on a number of criteria, not only on the level of risk of operations.

No. 431
If an institution has been given permission to use an AMA, no further formal authorisation is to be required in the context of a group-wide roll-out. It should be clarified that this proposal also applies to a roll-out of the AMA at solo level. Moreover, option 3 is at odds with the recommendation that no further formal authorisation should be necessary on roll-out.

No. 437
The use test is deemed an important element in the supervisory review and the model approval process. The principles, however, are described as non-exhaustive. In order to avoid expectation gaps, in-depth discussions between supervisors and industry should be launched. In consequence, we recommend amending the text as follows: "... are neither meant to be exhaustive nor exclusive". This would clarify that institutions can apply different approaches to satisfy the use test.

We would also point out that our understanding of the term "operational risk measurement" as used here covers both input parameters as well as the result, that is to say the amount of the value-at-risk ratio, for example. We would appreciate clarification.

Finally, we would like to make an important point concerning Principle 4:
The close relationship between the information resulting from the operational risk measurement system and management actions exists at lower organisational levels. Reports to the board, however, have more of an informational character, since actions have been already triggered.

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Reports to the board and their further use do not therefore lend themselves to monitoring the use test criteria. In consequence, the term "management" as used to describe an organisational unit should be more clearly defined to the effect that it refers to the senior management responsible for operational implementation.

No. 438

We suggest deleting the list in no. 438. It confuses rather than clarifies and offers no real additional information.

No. 442

The reconciliation between operational risk loss data and accounting data is an issue which has been discussed in various settings.

The following points need to be considered:

- operational risk losses are not always booked individually (e.g. salaries will be integrally booked; overtime compensation due to operational risk will not be itemised);
- operational risk losses are not always adequately reflected in the general ledger (e.g. loss of assets which have depreciated);
- operational risk losses can be booked in a number of accounts: it will be difficult to filter all out;
- operational risk losses sometimes need to be based on estimates: these estimates will not be booked.

Therefore we suggest the following rewording: "a review for cross-checking **material** operational risk loss data with accounting data...".

No.445

According to no. 445, institutions should develop their own standards for ensuring that their loss data is of high quality and improve these on an ongoing basis. They should be able to demonstrate a high quality of coverage, completeness and correctness. It should be clarified that this refers only to data on material loss.

No. 448

We believe it is superfluous to spell out detailed requirements concerning the way data is stored and documented in OpRisk management. Banks have general guidelines on recording and

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documenting data. These also apply to the area of OpRisk management and should therefore be sufficient.

No. 451

"Minimum loss threshold <...> impact on the computation of expected and unexpected loss." This is not a feasible assessment requirement. Impact studies on lowering the threshold are impossible due to the lack of data.

No. 452

The high-level principles on validation for IRB are also valid for AMA according to no. 452. We take a critical view of transferring the application of principles in this way. On the one hand, CEBS refrains from providing more concrete guidance in view of the challenges of OpRisk validation. On the other hand, reference is made to a set of general principles essentially developed with credit risk in mind. It would be helpful to see some examples for these high level principles like those shown for IRB in section 3.5.1, since these examples cannot be easily projected to operational risk.

No. 455

A reference is made to scenario analysis providing "information on extreme events". In the Basel International Convergence document and in discussions with national supervisors, however, the term "tail-events" was used. It was our common understanding that real extremes were not meant if applied to the capital requirements for operational risk.

No. 460

We would like to highlight the well-known challenges associated with using qualitative data and the resulting limitations when it comes to measurement. With this in mind, we consider the proposed requirements unclear and unhelpful.

No. 463

The requirement "automatic renewal option with terms and conditions similar to the current terms and conditions, and has a cancellation period on the part of the insurer of no less than one year" cannot be adhered to under current market circumstances:

- conditions cannot be given for a period over one year, this is explicitly true for the premium amount;
- the usage of the term "cancellation period" is not clear. If the notice period is meant, the insurer is not able to grant a notice period of one year.

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The wording does not exactly reflect the CRD ("policies with a residual maturity of 90 days") and, under a pessimistic view, most of the banks will not be able to use the risk mitigating effect in their risk capital calculations.

No. 464
We would like to stress that the requirements set out here go far beyond the wording of the CRD and that we are therefore highly critical of such a stringent stance. We would suggest rewording this paragraph completely. We would also point out that the diversification and correlation effects are deemed to be synonyms in this section. After having calculated the risk capital on a group level, it is almost impossible to recognise the correlation effects in the allocation, since a retrograde approach is not possible. The final phrase should therefore be deleted.

No. 464
"Institutions are strongly encouraged to move towards allocation mechanisms that properly reflect the operational riskiness of the subsidiaries and their actual contribution to the consolidated capital charge." Some interpretations of this requirement imply that the capital allocated to a subsidiary should be determined by the delta between the total group and the group without the particular subsidiary in question. This raises concern over an unreasonable computational burden for firms using loss distribution approach-based calculations and may make some AMA group level calculations invalid, which is not in the spirit of the AMA.

No. 469
We would like to draw you attention to an incorrect reference. "See paragraphs 347 to 349 for the definitions of these terms" should be corrected to "... 357 to 359...".

No. 482
The "Operational Risk Management Function" is supposed to "design, develop, implement, execute, and maintain the measurement methodology". It should be clarified that tasks can be delegated, as is common practice.

Furthermore, "backtesting and benchmarking" are listed as a task of the operational risk management function. While benchmarking is a useful validation technique in the context of operational risk management, traditional statistical backtesting cannot be performed due to a lack of data. Therefore we suggest removing the reference to backtesting.

Sections 3.6 and 4.3.5 on Internal Governance

To avoid inconsistencies, we suggest consolidating sections 3.6 and 4.3.5 and making them applicable to both credit risk and operational risk. Accordingly our remarks on the rules on internal governance in the realm of credit risk correspondingly hold for operational risk.

No. 365
The first bullet point requires the approval also of the supervisory board for all material aspects of the overall risk control system. This should be reduced to an obligation for the board of managing directors to inform the supervisory board. Explicit approval should only be required from the managing board. The third bullet point requires all rating systems to be approved by the management body. The management body should be able to delegate responsibility and approval authority for technical details.

No. 366
See comment on no. 365, first bullet point.

No 369
This rule is unclear. These requirements should be adapted to reflect the conditions set by the directive, which requires the management body merely to have a general understanding of the rating systems and a detailed understanding of the ensuing management reports (Annex VII, Part 4, paragraph 123). Under the directive, the detailed understanding demanded in no. 369 is required only of "senior management".

No. 370
The envisaged allocation of functions to the supervisory function of the management body is not in line with national requirements and should be dropped (cf. also comments on previous paragraph).

No. 371
The recipients of the risk reports are to include not only the management bodies, but all persons responsible for originating and monitoring credit risk. This goes beyond what is required under the directive and should therefore be deleted.

Furthermore the requirements are not in line with all national European laws. In Germany, for example, national law already defines what information has to be provided by the board of managing directors to the supervisory board. The primary recipient of internal reporting should be

the board of managing directors. Information to the supervisory board (or its committees) should be based on those reports, but does not have to be identical or contain as much detail as required by this paragraph.

No. 377

The management body is already required to ensure the appropriateness of the control mechanism and measurement system on an ongoing basis (no. 369). This paragraph is inconsistent with that requirement in that the credit risk control unit is now called on to report in detail twice a year. Such detail could be assessed just as well by a senior committee. The reporting requirement should therefore be dropped.

No. 385

To fulfil these requirements it is necessary to subordinate the head of the control function to a person who has no responsibility for the activities that are being monitored and controlled. This technically implies that risk methodology and validation units may not be part of the risk management function, which is common practice in many institutions.

Last bullet point: at least remuneration depending partly on the overall performance of an institution should be possible. The absolute character of this requirement should be avoided.

No. 388

The decision on how to develop rating models and who should be involved should be up to each individual institution. This is an example of the inherent over-regulation of the guidelines, as the quality and application of rating methods within the credit process are already part of the directive and are even assessed by supervisors in the approval process.

Nos. 389-392 (internal audit)

The tasks of the internal audit defined in Nos. 389-392 go far beyond the requirements of Annex VII, Part 4, paragraph 130. These tasks require employees with strong mathematical expertise (quants) in the internal audit function. This is not necessary. It is our understanding that the internal audit function needs only a basic understanding of mathematical and statistical methodology. The sole task of the internal audit should be to examine the processes of model development and review, the processes of technical implementation of rating systems, the processes which should guarantee the quality of input data and the processes for inclusion of model output in the internal risk management systems.

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No. 396
Rating proposals made by corporate customer relationship managers are to be monitored by the risk control unit. It should be clarified that these requirements apply only to loans to companies, banks and sovereigns.

Furthermore the definition of “rigorous controls” should be deleted as it is too extensive.

Yours sincerely
For the Zentralen Kreditausschuss
Bundesverband deutscher Banken

Massenberg

Zattler