

## Credit Risk Validation

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### New challenges in SSM framework

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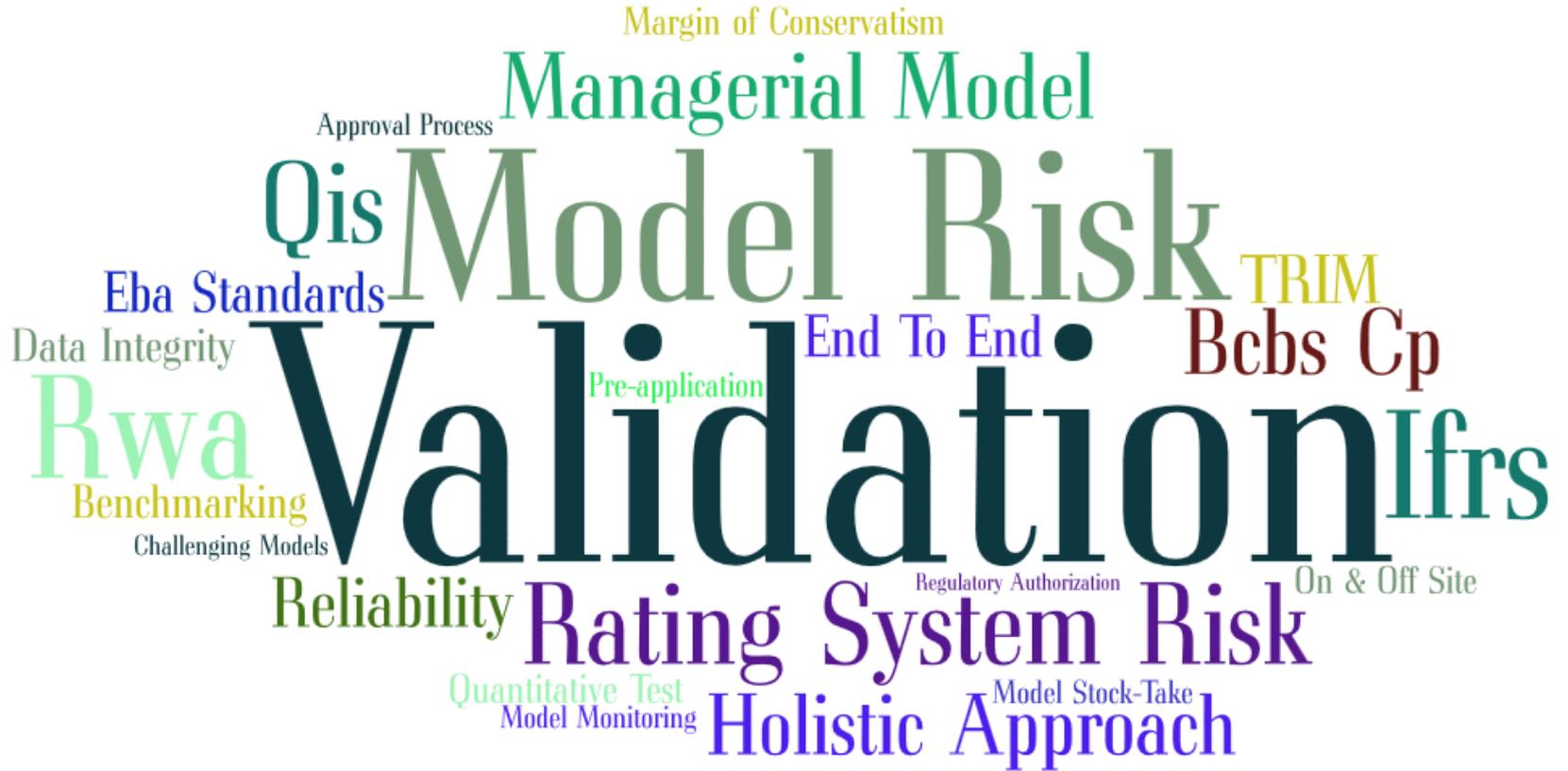
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Rome, 21<sup>st</sup> June 2016

# Validation Cloud

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# The impact of SSM and new EBA Standards on rating system validation practices

*Rules of game are changing*

- **The new European supervisory environment is changing the "rules of game" for rating model management**



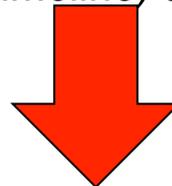
**Several and frequent "regulatory requests"** (e.g. EBA Benchmarking, QISs, Model Stock-take, Model Monitoring, etc.)



**Huge pipeline of new "regulatory requirements"** (e.g. new EBA Standards: EBA/CP/2014/36, DoD RTS, upcoming GLs for PD and LGD model development, etc.)



**Change in Regulatory assessment of Internal Models** (e.g. pre-application phase, DG IV role, approval timeline) and launch of **TRIM** Targeted Review of Internal Models

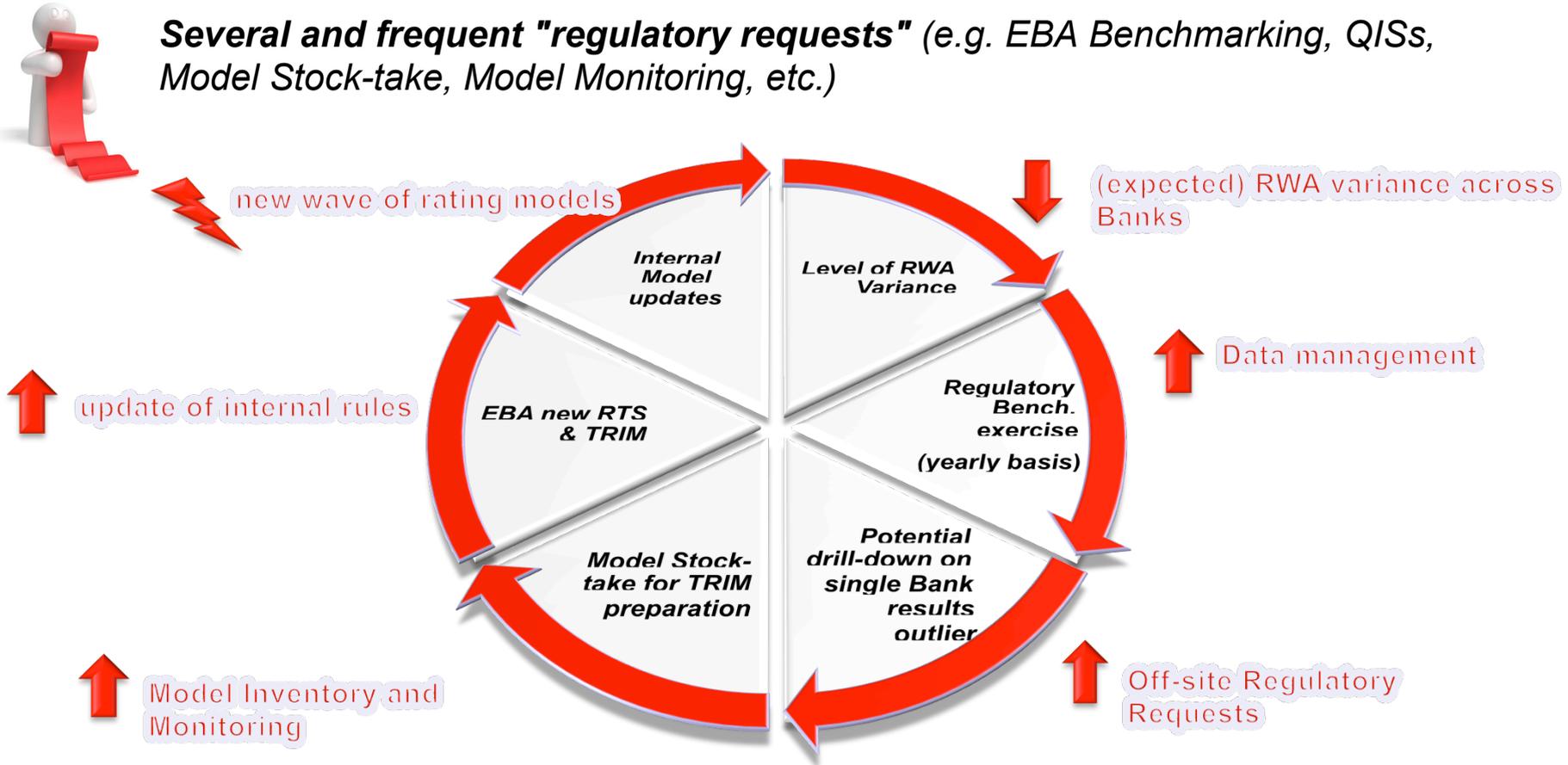


**Need for Internal Validation role and practice re-think ?**

# The impact of SSM and new EBA Standards on rating system validation practices

*Several and frequent "regulatory requests"*

**Several and frequent "regulatory requests"** (e.g. EBA Benchmarking, QISs, Model Stock-take, Model Monitoring, etc.)



**Increasing effort for data management, data quality assurance, benchmarking activities, regulatory off-site requests, etc.**

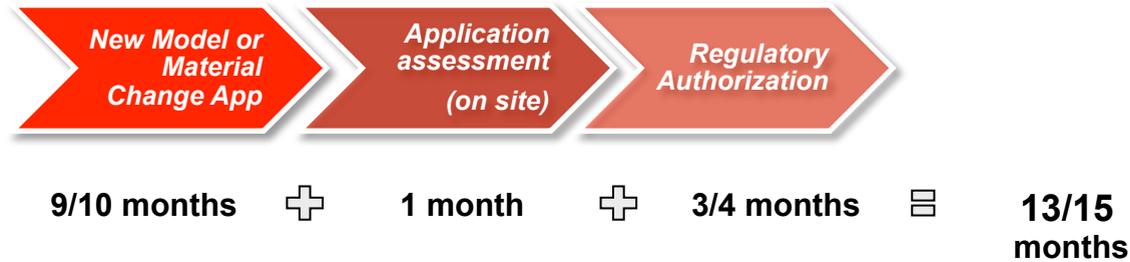
# The impact of SSM and new EBA Standards on rating system validation practices

## Rating model Regulatory assessment - Process Changes



**Change in Rating model Regulatory assessment** (e.g. pre-application phase, DGIV role, approval timeline)

**National CAs Process**



**SSM Process**



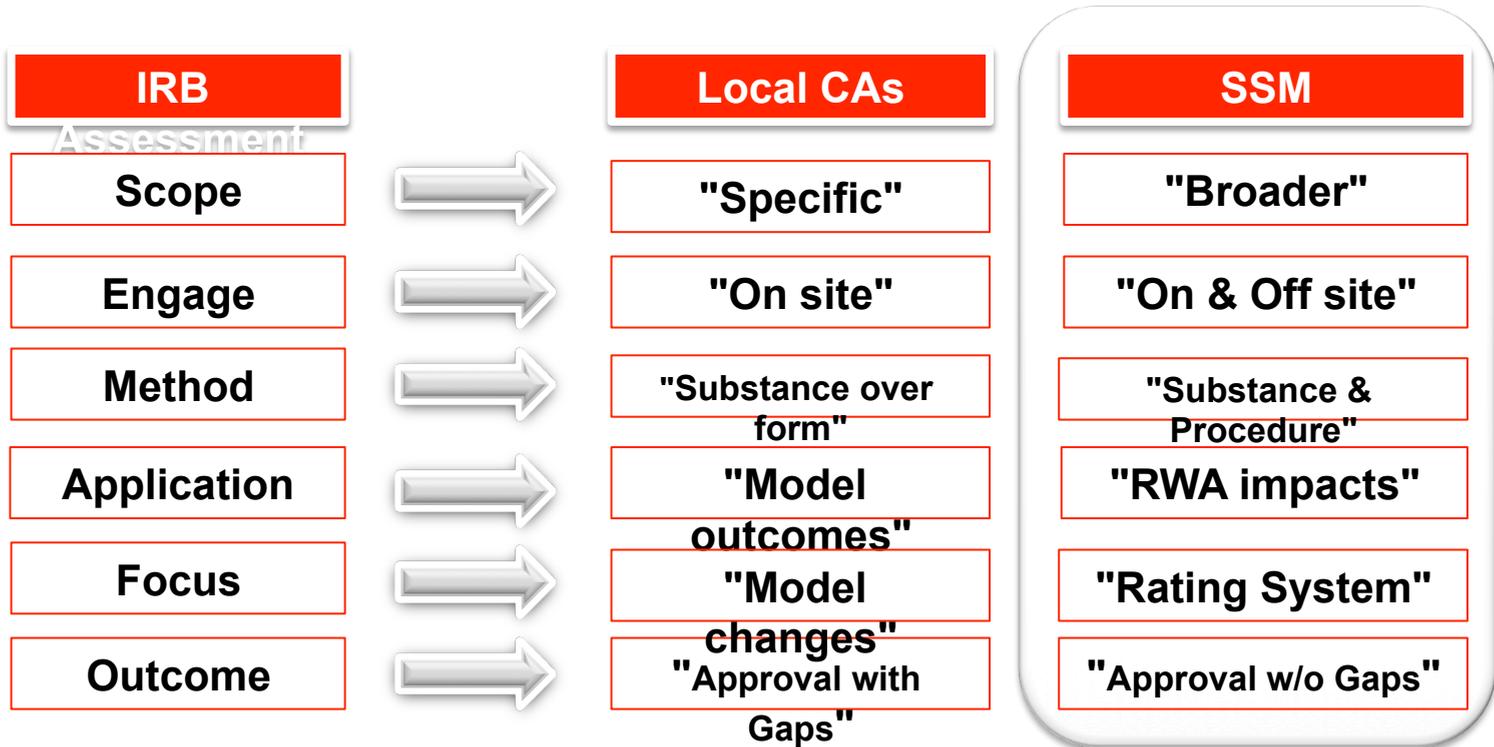
**Longer and more complex regulatory approval process forces to re-think the management of internal model searching for being more responsive to business and portfolio changes**

# The impact of SSM and new EBA Standards on rating system validation practices

*Rating model Regulatory assessment - Content Changes*



**Change in Rating model Regulatory assessment** (broad based assessment, regulatory requirements interpretation, margin of conservatism, etc.)



**"SSM approach" - Deeper and broader assessment, from "Model Risk" to "Rating System Risk", greater attention to RWA impacts**

# Rethink the Internal Validation role, process and practice

*General Remark*

- ***The new "rules of game" for rating model management require a change in the Internal Validation concept***



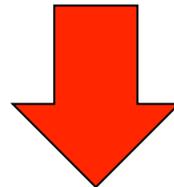
***Regulatory pressure is growing in a number of modelling and validation areas (e.g. availability and quality of data, methodology, monitoring process and mitigating actions, governance, etc.)***



***Expectation of use of conservatism and other measures to reduce "model risk" (broader definition of model risk)***



***Timing of Regulatory Model Approval is becoming critical both in term of credit risk management and business needs***



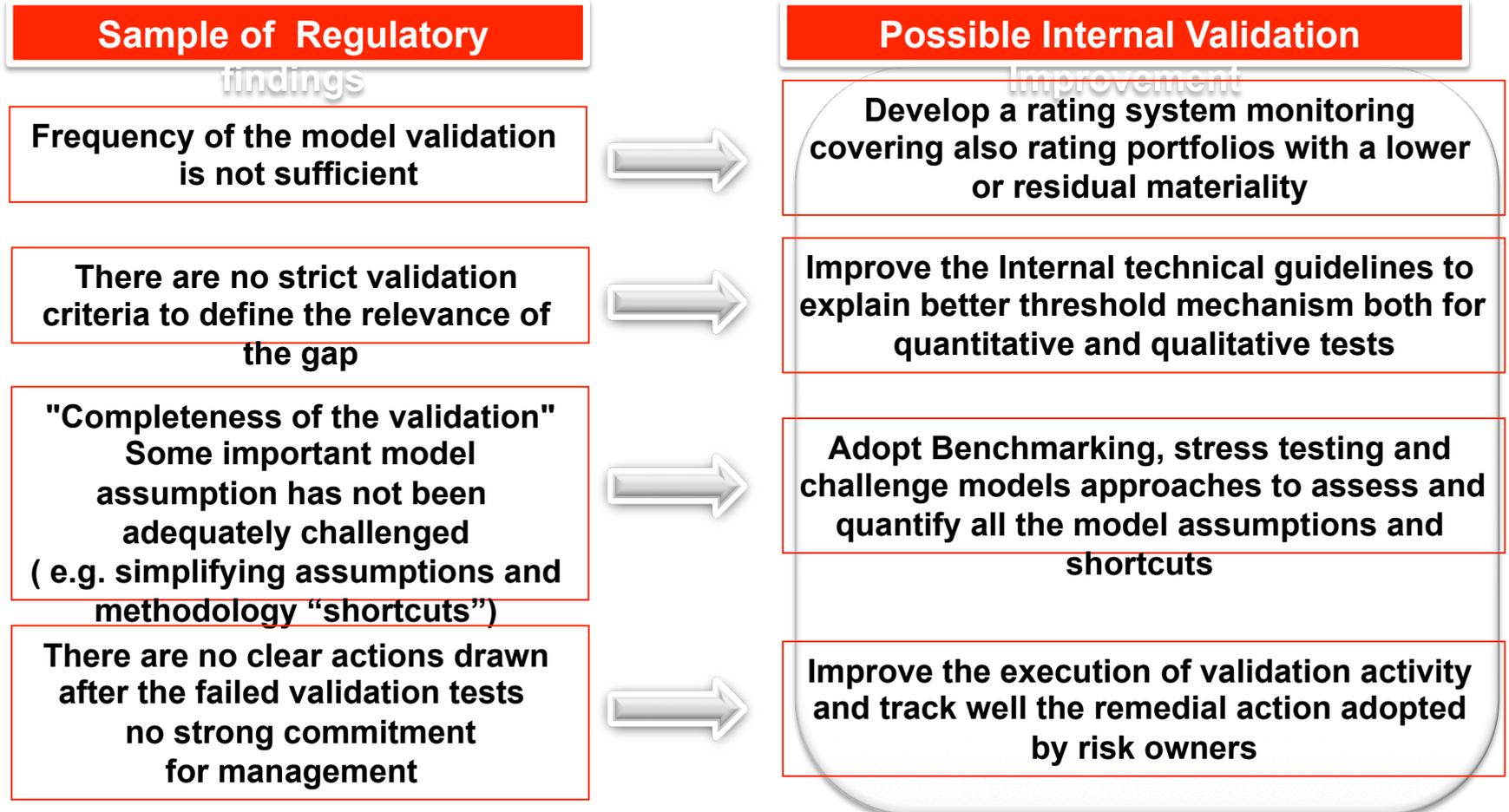
***Rebuild internal model management process!***

# Rethink the Internal Validation role, process and practice

*Regulatory pressure is growing in a number validation areas*



**Regulatory pressure is growing in a number validation aspects**



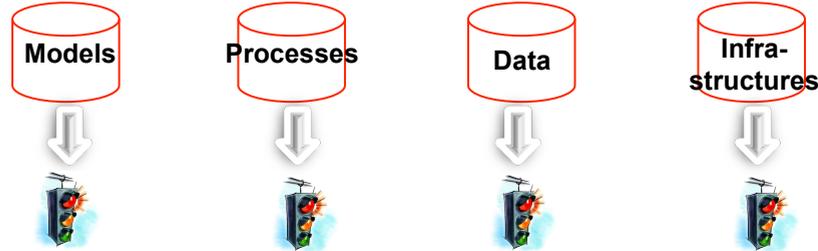
# Rethink the Internal Validation role, process and practice

Key aspects to the renewal of validation content

## Needs for Steps Forward in Validation Methods & Contents

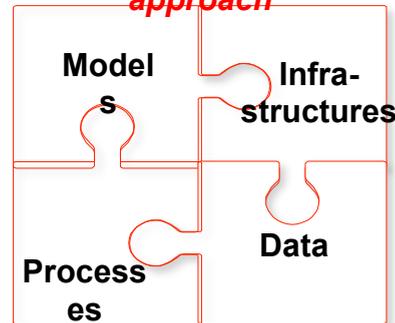


From a "silo approach" to a holistic validation assessment of rating system



- **Correctly assess margins of conservatism** (linked directly to specific model uncertainties through the different development steps)
- **Improve measurement of test reliability** (especially for Low Default Portfolios)
- **Link between test reliability and model conservatism**
- **Leverage on Industry benchmarking** (Data Pooling initiative)
- **Assessment of forward looking components of rating systems**
- **Challenging Models**

**holistic validation approach**



- **deeper monitoring about homogeneity of default definition** (Default Detection & Propagation, Group Mapping and Segmentation)
- **deeper monitoring about rating process** (4 eyes principle and level of independency → integrity)

- Improve **validation of Business & Technical specification** to limit possible Model miscoded
- Improve **UAT verification**
- Improve **"cross-controls"** on **RWA calculation**
- Implement a **data fault injection process**
- Improve **data quality reporting** (Tableau de Bords)
- Define **overrides, aging, missing data thresholds** in more quantitative way

The views expressed are those of the author and not necessarily those of Unicredit Group

# Rethink the Internal Validation role, process and practice

*Time Squeeze for internal model management*



**Timing of Regulatory Model Approval is becoming critical both in term of credit risk management and business needs**

**SSM Process**



9/10 months

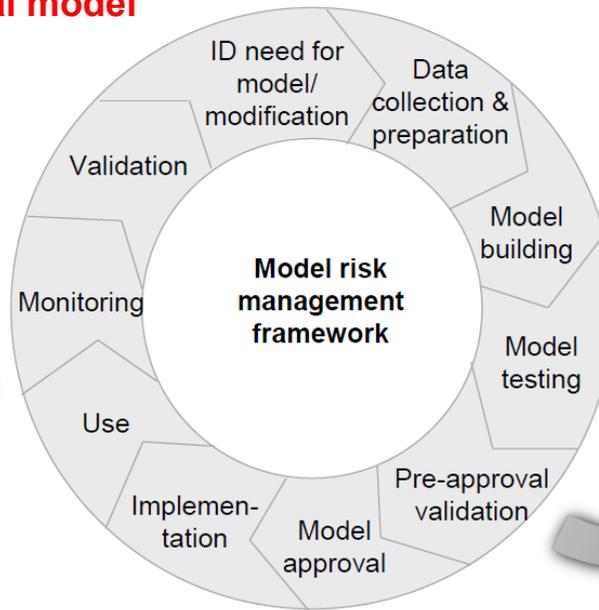
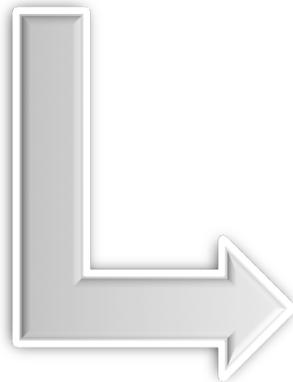
4 months

1/3 months

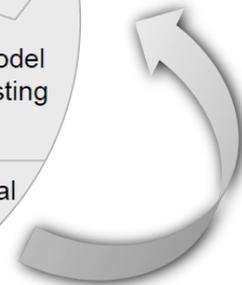
4 months

**18/21 months**

**shorten the time to internal model management**



**Define and adopt modeling standards**  
**Anticipate the internal model validation**  
**Design new specific check points**  
**(Data sharing, Self assessment**  
**Model validation check list)**





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**Thank you very much for your attention**