THE IMPACT OF THE NEW SUPERVISORY REVIEW PROCESS IN EU

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TOPICS OF THIS PRESENTATION

- Incoming regulatory actions
  - Model Quality Review
  - New IRB
  - New SREP
- Impact
- SAS

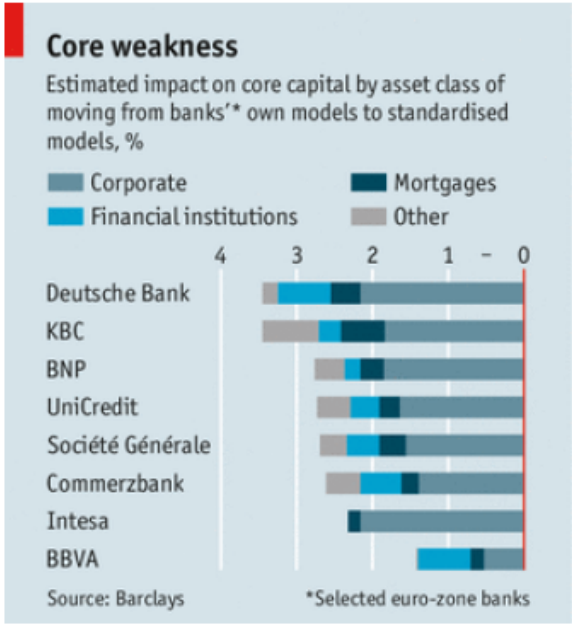
ISSUES IN CREDIT RISK ESTIMATES ACROSS EU BANKS

Gentlemen, start your audits

Close scrutiny of Europe's banks may turn up unexpected shortfalls

The Economist - Oct 5th, 2015

One issue is the "risk weighting" of assets, a process by which banks adjust the size of their capital buffer to account for the riskiness of their lending. Studies by both the Basel Committee, a club of central bankers and supervisors, and the EBA have found wide and unjustifiable variations in the way banks risk-weight their assets, even when asked to do so for identical hypothetical portfolios. The consequences of such variations can be significant. If the euro area's biggest banks were forced to abandon their internal risk-weighting models and instead apply cruder standardised models, many would see their core-capital ratios decline by several percentage points (see chart). The ECB is likely to push for greater consistency in risk weighting, which could force banks in France, Germany and elsewhere to raise capital.



http://www.economist.com/news/finance-and-economics/21587225-close-scrutiny-europes-banks-may-turn-up-unexpected-shortfalls-gentlemen-start

ECB APPROACH TO RISK WEIGHT VARIATIONS

- Risk Weights are determined by PD, LGD and CCR models under the IRB approaches

- Regulatory actions:
  - One-time : model quality review campaign across EU banks
  - Regime : review of supervisor assessment methodology for IRB Approach

- **Model Quality Review** (from ECB) – *now expected to start*, will continue over the next 4 years, covering all Banks supervised by ECB. Will review all existent models in use.

- **New methodology for Supervisors assessing Institutions on IRB Approach** (Technical Standard defined by European Banking Authority, EBA) – discussion paper being submitted to European Commission by 2015.

NOW | MODEL QUALITY REVIEW

- In the context of the Comprehensive Assessment, ECB set up a program for the review of all models used by the Banks under direct supervision (123 Institutions)
- Current estimate is that the 123 Banks are using approx 7000 models
- All models will be validated by ECB
- ECB estimate approx 4 years to complete the task
- Service providers have been asked to submit for support.

Not all of the banks' supervised by the ECB use internal models to calculate capital, but the biggest names including Deutsche Bank, Santander, UniCredit, BNP Paribas and Société Générale all do.

The banks most affected by the ECB review are likely to be those that have aggressively used models to reduce their RWAs and flatter capital ratios.

- http://www.ft.com/intl/cms/s/0/08003650-42a2-11e5-b98b-87c7270955cf.html#axzz3pgkiLOTY

COMING | NEW IRB ASSESMENT GUIDELINES

Assessment methodology for rating systems design, operational details and documentation (p. 60)

Key issues:

- Full documentation of model design
- Sound model design framework in place, including promotion to production
- Sound model validation and monitoring system in place
- Sound data quality in place

Guidelines are pending adoption by European Commission in 2015.

CP ON DRAFT RTS ON ASSSESSMENT METHODOLOGY FOR IRB APPROACH

EBA EUROPEAN BANKING AUTHORITY

EBA/CP/2014/36

12 November 2014

Consultation Paper

Draft Regulatory Technical Standards
On the specification of the assessment methodology for competent authorities regarding compliance of an institution with the requirements to use the IRB Approach in accordance with Articles 144(2), 173(3) and 180(3)(b) of Regulation (EU) No 575/2013

CONSEQUENCES

- Re-validate all current models in place
- Demonstrate to Supervisor an appropriate *model management framework*:
  - Management of data for model development and validation
  - Model development documentation
  - Model inventory
  - Model validation environment
  - Model monitoring environment / reporting
  - Estimate of model impact
  - Governance of models / management of model risk

- All banks whose model development environment and/or model validation & monitoring environment are not up-to-date will need to improve, investing more in those aspects

SREP

The EBA proposed a new standardized approach to the supervision process with the draft of the “Guidelines for common procedures and methodologies for the supervisory review and evaluation process” (SREP guidelines) of July 7, 2014 (fulfillment of article 107 Para. 3 CRD IV).

Those guidelines are to be applied by the ECB as well as the national supervisory authorities of the EU when assessing and evaluating the institutions.

The guidelines are to be applied from January 1, 2016 on, whereas interim arrangements are planned for implementing regulatory measures.

GL ON COMMON PROCEDURES AND METHODOLOGIES FOR SREP

EBA EUROPEAN BANKING AUTHORITY

EBA/GL/2014/13

19 December 2014

Guidelines

on common procedures and methodologies for the supervisory review and evaluation process (SREP)

NEW SREP | SREP FRAMEWORK

EBA Guidelines introduce a common *SREP framework* that includes 4 specific components:

- business model analysis;
- assessment of internal governance and institution-wide control arrangements;
- assessment of risks to capital and adequacy of capital to cover these risks; and
- assessment of risks to liquidity and funding, and adequacy of liquidity resources to cover these risks.

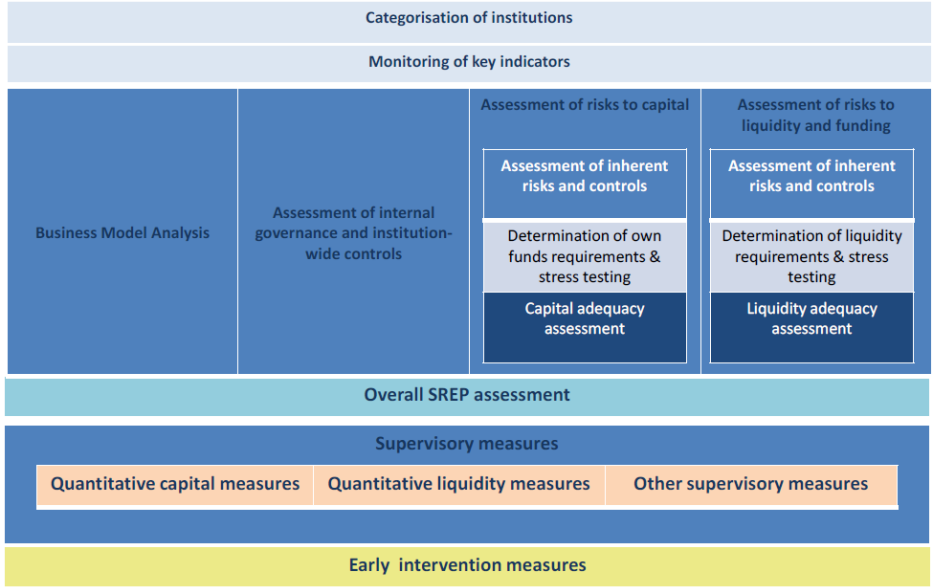
Regular monitoring of key indicators is used to identify material changes in the risk profile of Banks.

For each Institution, the 4 components of the SREP framework are assessed and scored on a scale of 1-4.

The outcome of the 4 assessments forms the basis for the overall SREP assessment, which represents the up-to-date supervisory view of the institution's risks and viability.

The *summary of the overall SREP assessment* is the final outcome produced by Supervisors. It should form the basis for supervisory measures and dialogue with the institution.

Figure 1. Overview of the common SREP framework



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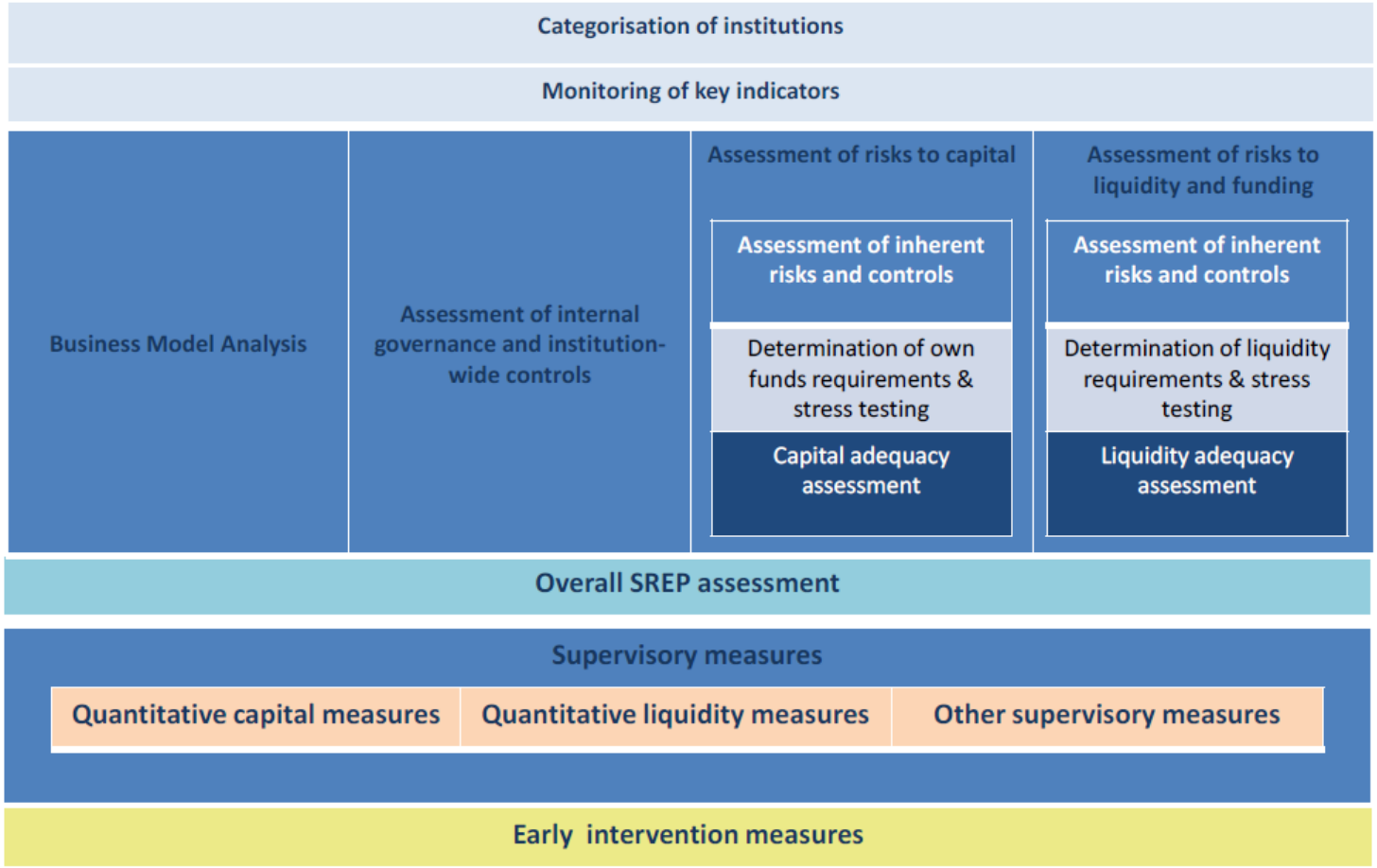


NEW SREP IMPACT ON RISK MANAGEMENT SYSTEMS

To cope with the New SREP process, Banks are currently planning improvements or even full re-engineering of several components of the Risk Management System.

Changes linked to new SREP assessment components structure:

1. Monitoring of key indicators
   - **Extension of existing quarterly reports** to competent autorities (medium/low impact)

2. Business Model Analysis
   - Ability to **simulate strategic plan with institution specific scenarios** (medium impact)

3. Internal Governance and Controls
   - **Compliance with BCBS239 RDAR general requirements** (high/medium impact), in particular on risk data management, data quality and reporting

4. Risks to Capital Assessment
   - **Internal capabilities for Stress Testing and Model Risk** are more relevant. Every single type of risk should be qualified via stress test on an institution-specific scenario set. (high impact)
   - Need for more **integration of Planning (i.e. Finance) and Risk Management systems** and data structures to be able to deliver overall forward looking risk to capital assessment (medium impact)
   - Improvement in the analysis of business environment – Ability to generate institution-specific scenarios
   - Top-down and bottom-up analysis systems are needed to sustain interaction with Supervisor authorities

5. Risks to Liquidity and Funding
   - Same as previous point (high impact)

CONSEQUENCES

- Many more model to include into the *model management framework*:
  - Stress Testing (regulatory exercises and internal modeling)
  - Business Models
- Need to simulate models onto full portfolios to fine tune
- Need to include scenario management across risk models
- Need to account for balance sheet impact of models / scenarios

SAS VISION FOR RISK

HOW TO SUSTAIN OUR LEADERSHIP POSITION

Improve our position on

- *Organizational Strength*
- *Customer Satisfaction*

- *Global SAS Organization*
- *New Risk focused global unit*

Maintain top position in:

- *Functionality*
- *Core Technology*
- *Market Presence*
- *Innovation*

- *Development Priorities*
- *Directional Themes*

WHAT'S NEW

- **Single point of contact for Risk:** New division restructures and consolidates multiple divisions, creating alignment on objectives/priorities; leadership and direction (vision) responsibilities lie within RQS
- **Organization now aligned to better execute:** R&D with clear set of goals managed by Solutions Leads and driven by customers/market; delivery (PSD and other) in-sync with goals and objectives of RQS; SSO Risk offerings being reconciled and coordinated with RQS
- **Disciplined and focused:** SAS Risk will focus on markets where we are well positioned with our expertise, our risk solutions, and our ability to deliver.
- **Architect for the long run but embrace the need to adapt:** Rationalize the risk portfolio and investments; reusable components; products designed to evolve; products and solutions designed with the ability to easily incorporate (and mange) content/IP
- **Customer driven agenda:** Engagement model that embraces collaboration; RQS Risk Business Consulting capabilities (industry SMEs) to deepen relationships and trust; partner along for the entire journey
- **Relevant and compelling content:** Risk solutions must ship with content (IP); enabled by hiring SMEs, partnering with consulting firms, and/or direct customer collaboration

SAS RISK MANAGEMENT

THEMES AND PRIORITIES

DIRECTIONAL THEMES

- Risk Management as well as Risk Measurement
- Premier Risk Quantification Engine
- Focus on Major Risk Areas
- High-Performance Scalability
- Address Evolving Regulatory Compliance

DEVELOPMENT PRIORITIES

- ✓ Enhancing usability and workflow
- ✓ Adding out-of-the-box capabilities
- ✓ Streamlining our product offerings
- ✓ Improving scalability
- ✓ Strengthening our core quantitative competencies
- ✓ Content-rich solutions

NEW REGULATIONS | SAS VIEW

- Continue / expand capabilities of ***SAS Credit Scoring*** and related solutions
- Provide a ***Model Governance solution***
- Improve ***SAS Risk platform capabilities*** to better support analyst in managing models

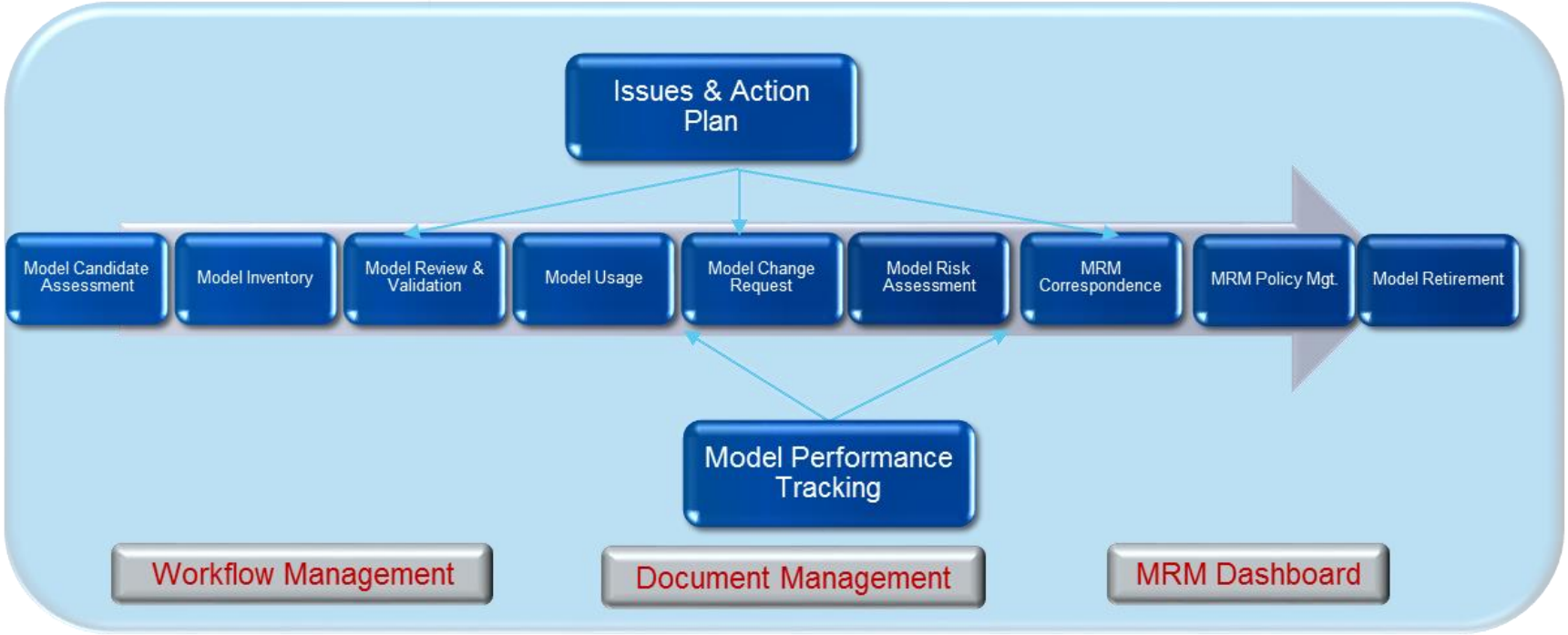
SAS CREDIT SCORING FOR BANKING

- Credit Scoring – new topics under development
  - Connection with Real Time Decision Management solution
  - Limit management
  - Coverage of extended set of models

- Regulatory Risk Management for Banking
  - RWA Calculation
  - Reporting

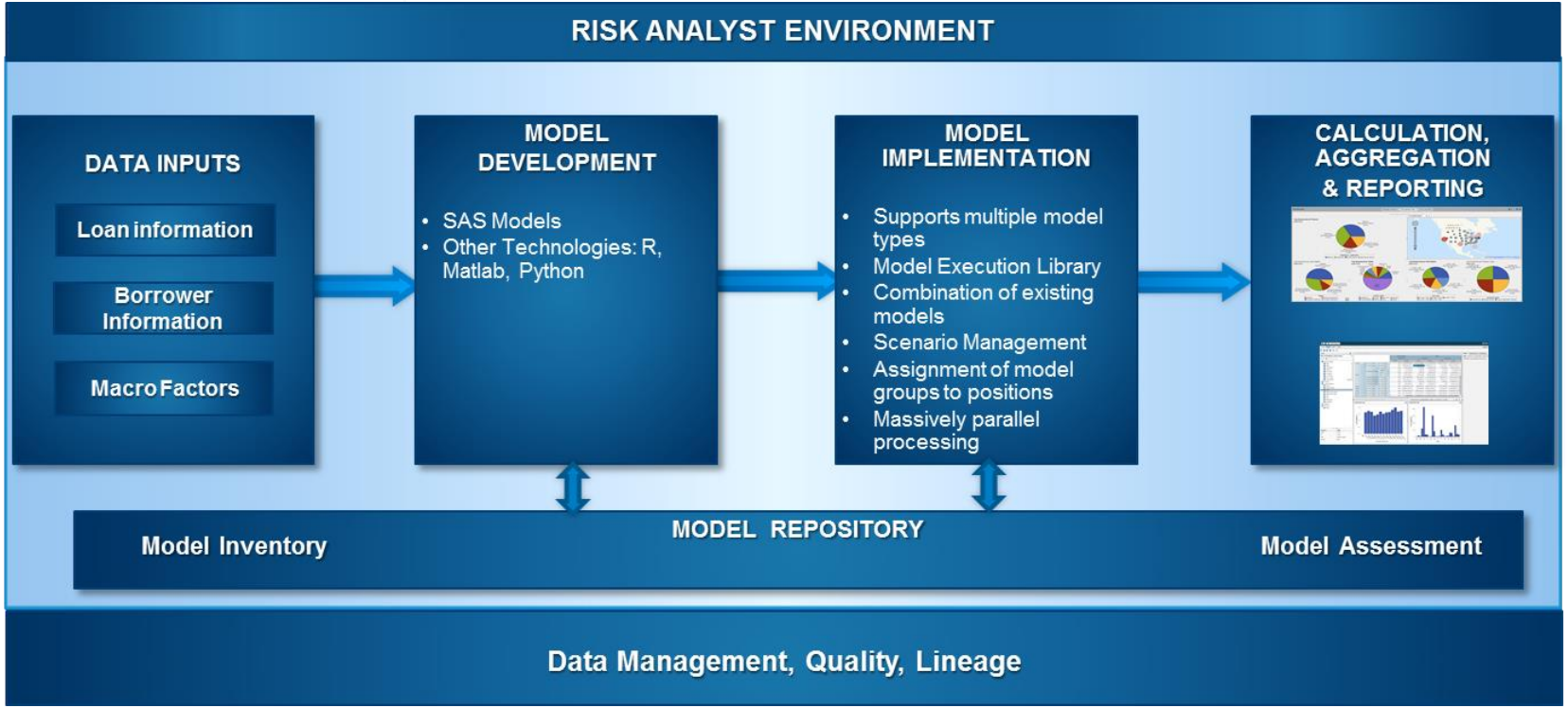
MODEL GOVERNANCE

SAS MODEL RISK MANAGEMENT

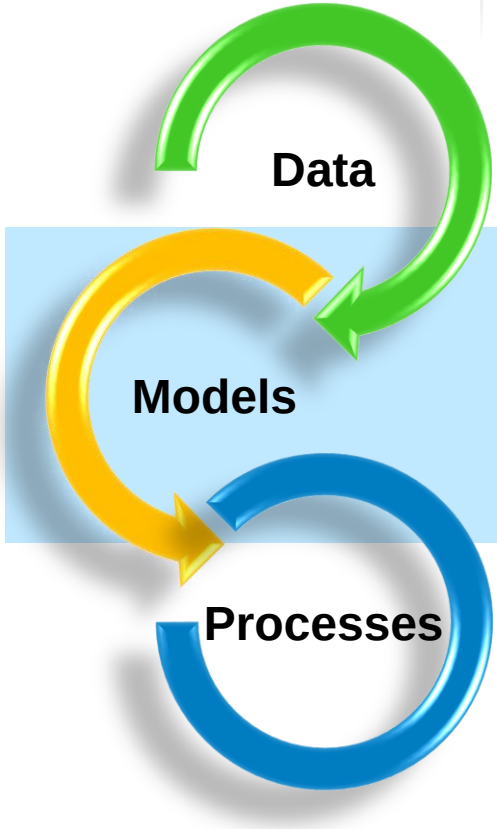


MODEL ANALYST SUPPORT

SAS MODEL IMPLEMENTATION PLATFORM



BCBS239 THE NEXT GENERATION RISK MANAGEMENT



Risk Data management

- Comprehensive Risk Data Governance across Banking Group LEs
- Full alignment with Finance
- Appropriate risk analysis & reporting capabilities

Risk modelling activities

- Development and deployment environments for all risk models
- Validation of all internal risk models formally supported
- Monitoring and Maintenance system in place for all risk models

Risk Information processing and decisioning

- Automation of all relevant risk processes
- Performance of risk aggregation and reporting processes ensured
- Governance of risk decisioning fully covered

CONCLUSIONS

- Regulations are forcing Banks to review their Risk Model Management operations
- There is an increasing need for
  - Improved Data Quality
  - Extended capabilities for Model development, validation, monitoring
  - More Governance and support to Supervisor engagement
- Stress Testing and IFRS9 will push all this topics even more
- SAS is focusing development along
  - Evovling existing modeling solutions
  - Complementing those solutions with an extended modeling and governance platform

THANK YOU FOR YOUR ATTENTION!

THE POWER TO KNOW.

sas.com