EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Press release

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ECB's large-scale review boosts reliability and comparability of banks' internal models

- ECB assessed internal models which banks use to calculate risk-weighted assets (RWAs) for credit, market and counterparty credit risks
- Large-scale review checked that banks comply with rules and implement internal models consistently
- Review resulted in €275 billion increase in RWAs over the last three years and more than 5,000 findings for banks to remediate

The European Central Bank (ECB) today published the results of its targeted review of internal models (TRIM). Large and more complex banks typically use internal models to determine some of their risk-weighted assets, which serve as a basis for banks to calculate their capital needs.

This review aimed to ensure that internal models comply with the rules and provide different outcomes only when the underlying risks are different. In other words, TRIM reduced non-risk-based variability of models' outputs. With 200 on-site investigations conducted in 65 significant banks using internal models, TRIM is the largest project ever carried out by ECB Banking Supervision.

"This large-scale exercise, the ECB's biggest project ever, contributes to a level playing field in European banking by ensuring internal models are reliable and their outcomes are comparable," said Andrea Enria, Chair of the ECB's Supervisory Board. "It confirms that consistently implementing internal models is possible even within a supervisory area as large as the banking union. Banks are following through to correct deficiencies and fully comply with the requirements. Our guide to internal models will support them in that respect."

The ECB identified over 5,000 findings and issued binding supervisory measures for banks to take corrective action within given deadlines. Through those measures, TRIM resulted in a 12% increase, or about €275 billion, of risk-weighted assets for the investigated models. Put differently: because TRIM discovered that the banks held more risks than they previously estimated, the Common Equity

Tier 1 ratio of banks using internal models declined on average by about 70 basis points as a result of TRIM over 2018-2021.

TRIM confirmed that banks can continue to use internal models to calculate risk-weighted assets, provided they remediate the identified shortcomings within the given deadlines, i.e. they restore full compliance with legal requirements. In the future, banks will need to continue to invest in high-quality models. For that purpose, it is particularly important that banks further strengthen their internal validation function. For its part, the ECB will continue its demanding risk-based supervision of internal models to ensure that banks continuously meet the requirements for the use of such models.

Good internal models are a basis for sound risk management. Bringing models in line with regulation better prepares banks to manage risks under regular economic conditions or to withstand extraordinary shocks.

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Notes

- A bank may use internal models to calculate its risk-weighted assets, instead of standardised formulas.
- A bank's use of internal models to calculate risk-weighted assets is first subject to initial approval by ECB Banking Supervision. Banks' internal models are then subject to internal model investigations (such as the ones conducted under the TRIM project) and to ongoing model monitoring by ECB Banking Supervision. This is how supervisors check whether the bank meets the requirements for using internal models.
- TRIM started in 2016 as a one-off large-scale effort to address possible inconsistencies resulting from the use of complex internal models and to reduce unwarranted (i.e. non-risk-based) variability of models' outputs.