

Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (Text with EEA relevance)

PART THREE

CAPITAL REQUIREMENTS

TITLE II

CAPITAL REQUIREMENTS FOR CREDIT RISK

CHAPTER 3

Internal Ratings Based Approach

Section 6

Requirements for the IRB approach

Sub-Section 2

Risk quantification

Article 182

Requirements specific to own-conversion factor estimates

- 1 In quantifying the risk parameters to be associated with rating grades or pools, institutions shall apply the following requirements specific to own-conversion factor estimates:
- a institutions shall estimate conversion factors by facility grade or pool on the basis of the average realised conversion factors by facility grade or pool using the default weighted average resulting from all observed defaults within the data sources;
 - b institutions shall use conversion factor estimates that are appropriate for an economic downturn if those are more conservative than the long-run average. To the extent a rating system is expected to deliver realised conversion factors at a constant level by grade or pool over time, institutions shall make adjustments to their estimates of risk parameters by grade or pool to limit the capital impact of an economic downturn;
 - c institutions' estimates of conversion factors shall reflect the possibility of additional drawings by the obligor up to and after the time a default event is triggered. The conversion factor estimate shall incorporate a larger margin of conservatism where a stronger positive correlation can reasonably be expected between the default frequency and the magnitude of conversion factor;

- d in arriving at estimates of conversion factors institutions shall consider their specific policies and strategies adopted in respect of account monitoring and payment processing. Institutions shall also consider their ability and willingness to prevent further drawings in circumstances short of payment default, such as covenant violations or other technical default events;
- e institutions shall have adequate systems and procedures in place to monitor facility amounts, current outstandings against committed lines and changes in outstandings per obligor and per grade. The institution shall be able to monitor outstanding balances on a daily basis;
- f if institutions use different estimates of conversion factors for the calculation of risk weighted exposure amounts and internal purposes it shall be documented and be reasonable.

2 For exposures to corporates, institutions and central governments and central banks, estimates of conversion factors shall be based on data over a minimum of five years, increasing by one year each year after implementation until a minimum of seven years is reached, for at least one data source. If the available observation period spans a longer period for any source, and the data is relevant, this longer period shall be used.

3 For retail exposures, institutions may reflect future drawings either in their conversion factors or in their LGD estimates.

For retail exposures, estimates of conversion factors shall be based on data over a minimum of five years. By way of derogation from point (a) of paragraph 1, an institution need not give equal importance to historic data if more recent data is a better predictor of draw downs. Subject to the permission of competent authorities, institutions may use, when they implement the IRB Approach, relevant data covering a period of two years. The period to be covered shall increase by one year each year until relevant data cover a period of five years.

- 4 EBA shall develop draft regulatory technical standards to specify the following:
- a the nature, severity and duration of an economic downturn referred to in paragraph 1;
 - b conditions according to which a competent authority may permit and institution to use relevant data covering a period of two years at the time an institution first implements the IRB Approach.

EBA shall submit those draft regulatory technical standards to the Commission by 31 December 2014.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.