



## Regulatory Compliance Strategy – Internal Ratings Based (IRB) Approach

### Abstract

The client was seeking approval to use the IRB approach to determine the credit risk regulatory capital charge on its retail exposures. Avantage Reply was asked to outline and agree the method of delivering 'Use Test' requirements within the client's European retail market operations, as part of the client's IRB approach application. Avantage Reply planned and implemented the key IRB steps required to achieve compliance within the regulator-imposed timeframe, while being mindful of the key risks and challenges for the programme.

### THE CLIENT

The client is an international bank with European roots with a clear focus on consumer and commercial clients in some key local markets and a global focus on select multinational corporations and financial institutions, as well as private clients. In retail and consumer banking, the client serves millions of clients around the world, including emerging markets.

### THE CHALLENGE

The client was seeking approval from its home regulator to use the Internal Ratings Based (IRB) approach to determine the credit risk regulatory capital charge on its retail exposures.

The objective of our engagement was to outline and agree the method of delivering 'Use Test' requirements within the European retail countries where the client operates. The key risks and challenges for the programme were:

- Data sets initially collected from the retail countries did not contain all data required for standardised and IRB analysis;
- The Group Finance Road Map could impact some source systems and processes required for the project;
- Significant change was occurring to operational front office and back office systems within the Retail countries; and
- The risk profile of the retail portfolios was expected to change as the various portfolios grew in size. Risk estimation needed to take this into consideration that historic analysis may not be an indication of future loss.

### APPROACH AND SOLUTION

Avantage Reply planned and implemented the key IRB steps to achieve compliance within the timeframe suggested by the regulator. Specifically, we

- Defined and maintained scope of activities and developed plans;
- Defined the reporting requirements to Basel II Programme and business-as-usual (BAU) stakeholders and staff;
- Oversaw Basel II Retail Training and Education;
- Defined the treatment of the Retail portfolio and documented exemption claims;
- Completed a gap analysis (Regulatory, Business, Functional and Data);
- Co-developed the Advanced IRB (AIRB) approach and rating models;

- Supported AIRB validation;
- Assessed and monitored compliance with Basel II Retail requirements;
- Ensured completeness of Basel II Retail Asset Coverage;
- Coordinated changes to underlying source systems and processes (including data quality improvements);
- Oversaw the collection of historical default and recovery data for validation purposes;
- Implemented data storage, validation and reconciliation to meet host and home requirements;
- Oversaw Basel II Retail IT development by Services IT;
- Performed test planning and acceptance testing (end to end) and parallel run; and
- Managed and coordinated the closure of gaps identified in the Basel II gap analysis.
- Assisted with the estimation of IRB risk parameters, which were difficult to estimate for some portfolios due to the low credit event experience in these portfolios. Growth plans also had to be considered as they were expected to change the make up of the portfolios.

## RESULTS AND BENEFITS

Avantage Reply provided a 'reality check' on the tasks required to achieve compliance with regulatory requirements. The client was in a better position to make an informed decision as they understood not only the potential benefits and the constraints, resources and commitment required to deliver against the regulatory requirements. The client gained a deeper understanding of the issues considered important to all stakeholders.

Avantage Reply also assisted in establishing the project and resource management requirement, including regular status reporting with project resources in addition to formalised project monitoring and reporting to management. Guidelines and templates were developed to assist in completing tasks on time.

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