

Content of question – The calculation of conversion factors under the IRB Approach

Piece of law	Decree No. 123/2007 Coll. (as amended) (hereinafter the "Decree")
Provision	• Art. 91, 3
Question	Is the resulting conversion factor capped at 100%, or is it possible for this conversion factor to exceed 100 % (e.g. if the difference between the exposure at default and the currently drawn amount is, for some reason, greater than the currently undrawn amount, e.g. due to interest and fees or an unauthorised overdraft)? Is there a situation where a conversion factor can be less than 0%?
Answer	<p>The conversion factor is defined in Decree No. 123/2007 Coll. (Art. 91, 3). Its definition implies that the event of an unauthorised overdraft is also covered. Therefore, the conversion factor being estimated by the liable entity can also be greater than 100%, because any overdraft, regardless of its character, is always reflected in the conversion factor.</p> <p>Negative conversion factors are not considered.</p> <p>Legal regulations do not generally prescribe a "single correct" procedure for the calculation of conversion factors. Subsequently, there are more possible ways and the choice is up to the liable entity. However, it is subject to approval by the competent authority.</p> <p>The liable entity should regularly perform model validation and back-test the conversion factors. The back-testing should demonstrate, inter alia, that the liable entity's estimates are sufficiently accurate.</p>
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Date:	19. 5. 2010
Further information for the recipient of the answer:	The answer reflects views of the staff members of the Czech National Bank. A court of law, or possibly the Bank Board of the Czech National Bank, may take a different point of view. However, a liable entity's practices that adhere to the answer will be considered, within the limits of the answer and its assumptions, to be in harmony with legal regulations, unless the inapplicability of the answer to the case in question follows from circumstances particular to the case.