

Content of question:

How shall the notion of 'material aspects of rating processes and estimation processes' pursuant to Annex 10, E, a) to the Decree be understood? How extensive documentation is to be approved?

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Approved by: **Pavel Vacek**

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Piece of law	Decree No. 123/2007 Coll.
Provision	Annex 10, E, a)
Explanation	<p>This specific requirement on the governance laid down in the above mentioned provision of the Decree and relating to a liable entity which asks for an approval to implement the IRB Approach underlines the responsibility of the board of directors for the rating system, which penetrates into numerous processes of the liable entity. Furthermore, the Decree stipulates that both the board of directors and the senior management shall possess an overall knowledge of the rating system. Therefore, they are supposed to understand the rating system and the related processes.</p> <p>This implies that it is up to the liable entity to determine the scope and the level of detail of the documents to be approved in order to meet the above obligation. Based on the past experience of the CNB, it can be assumed that material aspects of rating processes and estimation processes include especially the following items:</p> <ul style="list-style-type: none">- the way of dividing portfolios into segments – individual exposure classes,- the structure of rating systems – i.e. information on rating scales, including the distribution of exposures within individual scales or groupings,- the architecture of rating models – used data, types of models (mathematical and statistical models or expert models) and their application to individual exposure classes, aspects not covered by the models and resultant risks,- the particular setting-up and the way of the application of obligor default,- the models' validation and updating – the validation methodology and its overall results, the results of validation on local data, information regarding the methodology and frequency of updating the models,- stress tests – the methodology and results of tests, measures adopted on their basis,- the so-called use test – i.e. which areas and processes of the bank are impacted by the ratings (e.g. monitoring, approvals, limits, remuneration, establishing allowances etc.)- the used types of credit protection and their recognition in the IRB

Approach,

- the implementation plan for the IRB Approach, including the use of the STA Approach as part of the IRB Approach and possibly the usage of transitional provisions,
- carrying out the calculation of risk-weighted exposure amounts and expected credit losses.

For completeness's sake let us note that a bank or credit union must ensure pursuant to Article 10 of the Decree that all approval and decision-making procedures can be viewed retrospectively.