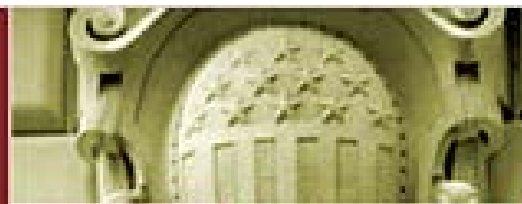


Supervisory Review of Qualitative
Approaches, Overlays and
Adjustments
2017 Modeling Symposium
Session 3A – October 5, 2017



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Supervisory Views from CCAR 2017

- Some good news
 - ✓ Using qualitative approaches and overlays is acceptable, provided they are done well
 - ✓ Certain firms are developing successful processes to develop qualitative approaches and independently review them
 - ✓ Also seeing some firms with sound processes for applying overlays/adjustments and reviewing those, too
 - ✓ Pleased to see different approaches applied
- But still some issues
 - ✓ Some firms are still not yet meeting supervisory expectations
 - ✓ Consistent application across the firm remains a challenge
 - ✓ In some cases, issues have persisted for several CCARs

Developing Qualitative Approaches

- Supervisors have identified issues with the development and application of qualitative approaches, including:
 - ✓ Poor quality and rigor
 - ✓ Inadequate transparency, support, documentation
 - ✓ Used to “arbitrage” around standards for models
 - ✓ Inappropriate application to new/different areas
- More recently, some firms have made strides
 - ✓ Internal standards for quality/rigor of qualitative approaches
 - ✓ Standards and controls for qualitative and quantitative approaches are similarly stringent
 - ✓ Justification offered for use of qualitative approach
 - ✓ First-line confirmation that approach is fit for purpose
 - ✓ First-line monitoring of output from qualitative approaches
 - ✓ Assumptions of approach very clearly outlined, justified

Reviewing Qualitative Approaches

- Supervisors have also observed some shortcomings with independent review of qualitative approaches, including:
 - ✓ Not subject to any review at all – or review much less rigorous
 - ✓ No consistent internal standards for independent review
 - ✓ Embedded quantitative elements not reviewed
 - ✓ Poor evaluation of assumptions used
- Some firms have improved review practices
 - ✓ Clear, consistent internal standards & use of review templates
 - ✓ Pairing of quantitative experts and business experts for full evaluation of the approach
 - ✓ Some firms include qualitative approaches within MRM
 - ✓ Others develop a separate second-line group
 - ✓ Heightened quality and consistency of second-line reviews
 - ✓ Second-line monitoring of qualitative approach output over time

Applying Overlays/Adjustments

- Overlays not always well developed or properly reviewed
 - ✓ Made “on the fly” or at last minute, with no independent review
 - ✓ Poor transparency for overlays/adjustments (esp. model-internal adjustments)
 - ✓ Broad overlay applied (across models or portfolios) as a “catch-all” buffer
 - ✓ Little support for overlays – how did they arrive at this number?
 - ✓ Overlays do not address underlying model issues/limitations
 - ✓ Automatic assumption that overlays are conservative
 - ✓ Some overlays dressed up as “in-model adjustments”
 - ✓ Excessive use of overlays across the firm or over time

Applying Overlays/Adjustments (cont)

- Better practices for overlays observed recently
 - ✓ Clear internal standards for application of all overlays
 - ✓ Roles and responsibilities for overlays explicit
 - ✓ Overlays/adjustments fully supported and documented
 - ✓ Overlays targeted to specific areas to address specific issues with primary/underlying approaches
 - ✓ Overlays subject to proper independent review, including quantitative & qualitative aspects
 - ✓ More frequent or sizable overlays subject to higher-level sign-off
 - ✓ Firm looks at full set of overlays applied, across models & portfolios